

# Open Research Online

---

The Open University's repository of research publications and other research outputs

## The role and impact of investment incentives on small and medium sized enterprise development in Ethiopia

### Thesis

#### How to cite:

Ayele, Seife (2003). The role and impact of investment incentives on small and medium sized enterprise development in Ethiopia. PhD thesis The Open University.

For guidance on citations see [FAQs](#).

© 2002 The Author



<https://creativecommons.org/licenses/by-nc-nd/4.0/>

Version: Version of Record

Link(s) to article on publisher's website:

<http://dx.doi.org/doi:10.21954/ou.ro.0000e7e6>

---

Copyright and Moral Rights for the articles on this site are retained by the individual authors and/or other copyright owners. For more information on Open Research Online's data [policy](#) on reuse of materials please consult the policies page.

---

[oro.open.ac.uk](http://oro.open.ac.uk)

# **THE ROLE AND IMPACT OF INVESTMENT INCENTIVES ON SMALL AND MEDIUM-SIZED ENTERPRISE DEVELOPMENT IN ETHIOPIA**

**Seife Ayele**

**BA (Econ.), PG Diploma (Econ.) and MA (Dev. Econ.)**

**This thesis is submitted for the degree of Doctor of Philosophy**

**Development Policy and Practice, Faculty of Technology, and**

**Open University Business School**

**The Open University**

**2002**

Author no. M7284877  
Submission date 14 January 2002  
Award date 8 January 2003

## **ACKNOWLEDGEMENTS**

I would like to thank Dr Joanna Chataway (DPP, Faculty of Technology) and Dr Colin Gray (Open University Business School) for their valuable supervision and guidance throughout the research programme. I am also very grateful to Dr Tom Hewitt (DPP, Faculty of Technology) who stood in for Dr Chataway in 2000 and constructively commented on my earlier draft chapters. My special thanks go to Dr Sharon Goodman, for her all round encouragement throughout the development of the research programme.

## Abstract

In 1950 Ethiopia became an African pioneer by introducing an industrial modernisation policy to attract foreign capital and technology transfer. It took further pioneering steps in the early 1960s by using its investment incentives scheme to support indigenisation of industry and SMEs. However, during the 1970s and 1980s while many countries were learning fast from the experiences of others, these early initiatives were suppressed in Ethiopia, and only reintroduced in the early 1990s with a narrow approach to enterprise start up, and few lessons learnt.

This thesis examines the role and impact of incentives, constituting exemptions from paying duties on imported capital goods and income taxes, on the choices of industry, location and size of enterprises in Ethiopia. It uses theories predicating the reasons for entrepreneurial motivations to start enterprises, and draws on statistics from 4246 projects licensed for investment incentives over 1992-98, as well as new evidence generated from a follow up in-depth investigation of six SMEs. The thesis concludes that the influence of investment incentives on the industry, location and size of SMEs start ups is limited. Antecedent factors like entrepreneurial experience, level of training and financial resources, alongside market and infrastructure were the triggers and determinants of SMEs start ups.

However, the study found that sometimes the value of the licence for investment incentives was superior to the holder when used, not as tax breaks as intended, but as a moderator of access to state controlled resources like enterprise sites. Projects that received licences looked viable for bank credit, and the authorities provided some projects with preferential (and subsidised) access to resources.

The study suggests that enterprise support initiatives should focus on key driving forces of enterprise development, such as entrepreneurs' technical and managerial skills, better access to land, infrastructure and streamlined procedures for business legalisation.



## Contents

<b>MAP OF ETHIOPIA</b>	<b>VI</b>
<b>GLOSSARY OF TERMS AND ABBREVIATIONS</b>	<b>VII</b>
<b>LIST OF TABLES AND FIGURES</b>	<b>IX</b>
<b>1. INTRODUCTION TO THE STUDY OF THE ROLE AND IMPACT OF INVESTMENT INCENTIVES ON SMEs DEVELOPMENT IN ETHIOPIA</b>	<b>1</b>
1.1 The nature of the study	1
1.2 Reasons for studying IIS impacts on SMEs development	3
1.3 Research hypotheses and questions	13
1.4 Conceptual framework and methodology	16
1.5 Major findings and the big picture of the study	22
1.6 Structure of the thesis	24
<b>2. THE THEORETICAL FOUNDATION OF PROMOTING SMEs START-UPS AND GROWTH WITH EMPHASIS ON THE INSTRUMENT OF INVESTMENT INCENTIVES</b>	<b>26</b>
2.1 Introduction	26
2.2 Theory and evidence on the re-emergence of the SME sector	27
2.3 The meaning of and rationale for investment incentives	41
2.4 Theories of SME start-ups and growth	50
2.5 Impacts of investment incentives on SMEs start-ups and growth	64
2.6 Conclusion	69

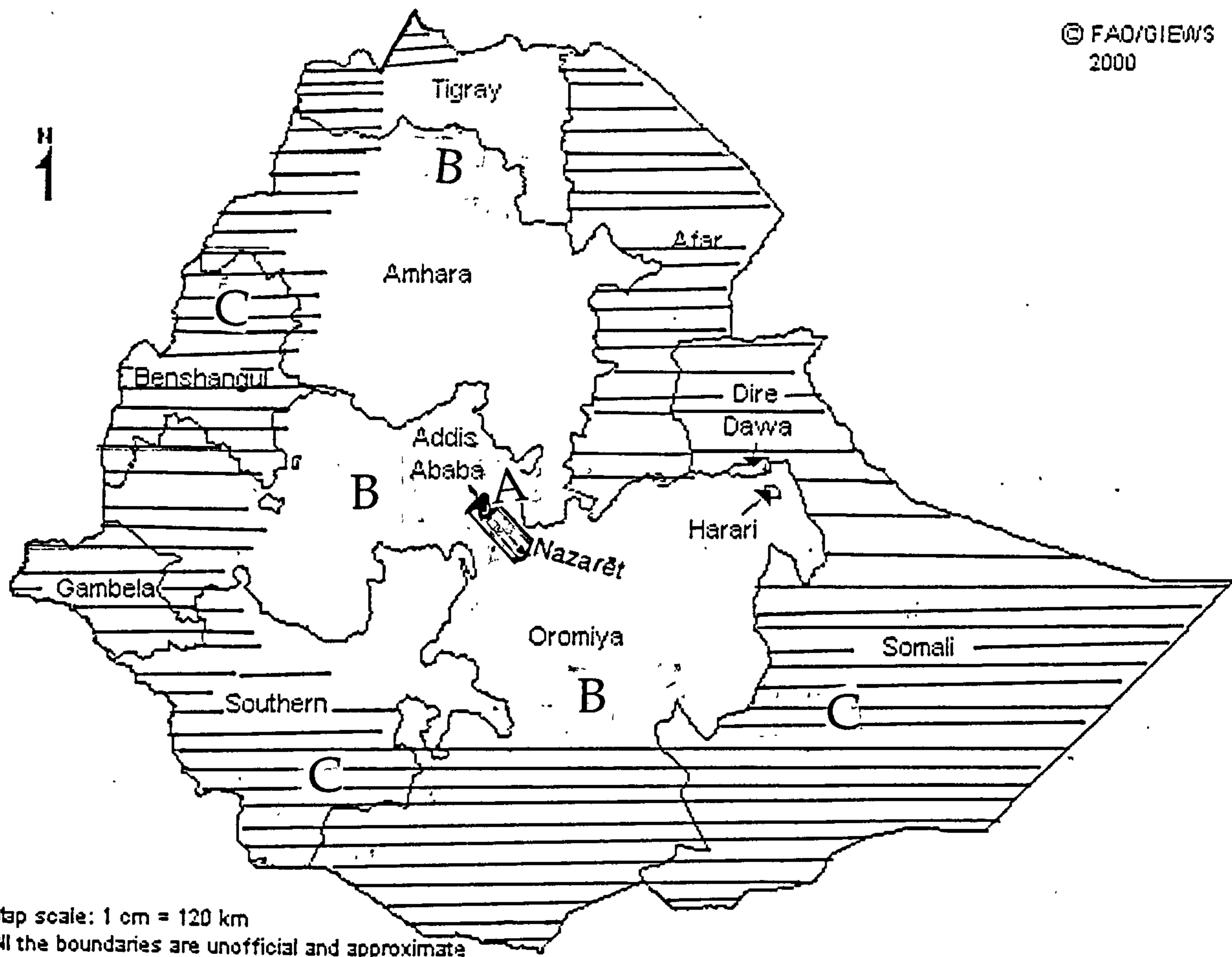
<b>3.</b>	<b>THE ETHIOPIAN ENTERPRISE ECONOMY AND THE EVOLUTION OF THE INVESTMENT INCENTIVES SCHEME</b>	<b>72</b>
3.1	Introduction	72
3.2	Background to the Ethiopian enterprise economy	73
3.3	Key features of the present Ethiopian enterprise economy	83
3.4	The evolution of the Investment Incentives Scheme and its institutions	93
3.5	Non-IIS institutions and instruments for enterprise development	104
3.6	Conclusion and links with the questions of the thesis	110
<b>4.</b>	<b>RESEARCH STRATEGY AND METHODS</b>	<b>112</b>
4.1	Introduction	112
4.2	Considerations made in choosing research strategies	112
4.3	Procedures and criteria for selecting SMEs	119
4.4	Methods of data collection and conducting the fieldwork	128
4.5	Analytical methods	132
4.6	Chapter summary	134
<b>5.</b>	<b>MAIN FINDINGS OF THE ENQUIRY INTO THE ROLE AND IMPACT OF THE IIS ON ENTERPRISE DEVELOPMENT</b>	<b>136</b>
5.1	Introduction	136
5.2	The dynamics and cost of IIS Assisted Enterprises: the macro picture	137
5.3	Rationale for supporting SMEs: views from government and professional agencies on enterprise development	154
5.4	The Investment Incentives Scheme and enterprise start up and growth: evidence from selected cases of SMEs	162
5.5	Access to key enterprise start up resources	184
5.6	Summary of the major findings	193

<b>6.</b>	<b>DISCUSSION ON THE ROLE AND IMPACT OF THE INVESTMENT INCENTIVES SCHEME ON ENTERPRISE START-UP</b>	<b>196</b>
6.1	Introduction	196
6.2	IIS objectives, instruments and rationales	196
6.3	The framework for discussing IIS impacts on enterprise start up	201
6.4	The link between enterprise start-up and the IIS	206
6.5	Evaluating the performance of the IIS	228
6.6	Summary and some explanations for the limited IIS impact on enterprise development	234
6.7	Conclusion	238
<b>7.</b>	<b>DISCUSSION ON THE ROLE OF THE INVESTMENT INCENTIVES SCHEME IN ENTERPRISE START-UP RESOURCES MOBILISATION AND BUSINESS LEGALISATION</b>	<b>240</b>
7.1	Introduction	240
7.2	The political economy of state control and distribution of resources	241
7.3	The role of the IIS in enterprise start-up resource mobilisation	252
7.4	The role of the IIS in reducing the business legalisation process	271
7.5	Conclusion	279
<b>8.</b>	<b>THESIS SUMMARY, CONCLUSION AND RECOMMENDATIONS</b>	<b>281</b>
8.1	Introduction	281
8.2	Summary of major findings of the thesis	282
8.3	Conclusion and Recommendation	287
8.4	Limits to generalisation and agenda for further research	296

9.	REFERENCES	299
9.1.	General references	299
9.2	Legal Documents	315
9.3	Statistical Documents	317
9.4	Interviewees	318
APPENDIX ONE: INTERVIEW QUESTIONS		320
APPENDIX TWO: LETTERS OF COOPERATION		335

## Map of Ethiopia

(showing regional state boundaries and distribution of investment incentives)



Source: adapted from United Nations Food and Agriculture Organization  
(<http://www.fao.org/giews/english/basedocs/eth/ethadm1e.stm>)

### Legend:

- A: The Investment Incentives policy is to support these areas least. The areas are Addis Ababa region and Addis Ababa-Nazareth Corridor (covering 15 km radius from both sides of the 100 km road connecting the cities of Addis Ababa and Nazareth).
- B: Policy is to support these areas at medium level – these are parts of the country (regions and zones) which fall between the centre and the peripheral regions – that is areas not included in categories A and C.
- C: Policy is to support these areas most – that is relatively undeveloped and peripheral regions including Benishangul and Gumz, Gambela, Ethiopian Somali region.

(Note that neither the investment incentives regulations, nor the above map, define areas B and C with complete accuracy. This map should therefore be taken as a rough guide only.)



## Glossary of terms and abbreviations

AA-API:	Association of Private Industries (for Addis Ababa)
AACC:	Addis Ababa Chamber of Commerce
ADLI:	Agriculture Development-led-Industrialisation
AEi/UEi:	Assisted enterprise/unassisted enterprise [i= 1, 2 and 3]
AIO:	Amhara (region) Investment Office
CBE:	Commercial Bank of Ethiopia
CCEs:	Cottage and craft enterprises
CIF:	Cost of insurance and freight
COM:	Council of Ministers
CSA:	Central Statistical Authority
DAHSI:	Development Agency for Handicrafts and Small Industries
DBE:	Development Bank of Ethiopia
DCs	Developed countries
Derg:	Socialist/military government that reined in Ethiopia over the period 1974-91. The Amharic word 'derg' means committee.
DTEs:	Distributive and trade service establishments
EC:	Ethiopian Calendar (which is behind the Gregorian calendar by about 7 years and 8 months).
ECC:	Ethiopian Chamber of Commerce
EDPs:	(US state-sponsored) economic development policies
EEA:	The Ethiopian Economic Association
EEPCO:	Ethiopian Electric Power Corporation
EIA:	Ethiopian Investment Authority
EMI:	Ethiopian Management Institute
EPRDF:	Ethiopian Peoples Revolutionary Democratic Front
Exchange rate:	<i>birr</i> 10.50 = approximately £1 (in 1998).
FDI:	Foreign Direct Investment
FDRE:	Federal Democratic Republic of Ethiopia
GNP/GDP:	Gross National Product/Gross Domestic Product

HASIDA:	(predecessor of DAHSI) Handicrafts and small-scale industries development agency
IGE:	Imperial Government of Ethiopia
IIS:	Investment Incentives Scheme (of Ethiopia)
IMF:	International Monetary Fund
<i>kebele</i> :	Rural/urban grassroots organisation.
LDCs	Less developed countries
LLO:	Land Lease Office
LRCD:	Licensing, Registration and Coordination Department at EIA.
MEDAC:	Ministry of Economic Development and Cooperation
MLMEs:	Medium and large manufacturing enterprises
MoF:	Ministry of Finance
MTI:	Ministry of Trade and Industry
NGOs:	Non-governmental organisations
OIO:	Oromia (region) Investment Office
OSS:	One-stop-shop services
PDRE:	Peoples Democratic Republic of Ethiopia
PEFD:	Project Evaluation and Follow up Department, EIA.
PMGE:	Provisional Military Government of Ethiopia
PRID:	Policy Research and Information Department, EIA.
SENNPR:	Southern Ethiopia Nations, Nationalities and Peoples Region
SMEs:	Small and medium size enterprises
SSA:	Sub-Saharan Africa
SSMEs:	Small scale manufacturing enterprises
TGE:	Transitional Government of Ethiopia
TIB:	Trade and Industry Bureau
WB:	The World Bank
<i>woreda</i> :	lowest political unit of government in Ethiopia.



## List of tables and figures

Box 2.1	Approaches to defining the size of an enterprise	29
Box 2.2	Concepts and measurements of impact analysis of enterprises support: deadweight, displacement, additionality and viability	67
Box 3.1	The definition of investment incentives in Ethiopia	94
Box 3.2	The concepts of the entrepreneur and investor in the Ethiopian conditions	103
Box 5.1	Tax rates and method of calculating revenue foregone to the IIS	150
Box 7.1	Resources and incentives distribution, regulation and controlling powers of public agencies	246
<hr/>		
Figure 1.1	Framework of environment for enterprise development, the investment incentives and enterprises start up systems	18
Figure 6.1	Enterprise start up stages and the role of investment incentives	204
Figure 7.1	An analysis of the dynamics of enterprise start-up through cohorts	268
<hr/>		
Table 1.1	Mapping changes and continuity in the use of the instrument of investment incentives in Ethiopia during 1950-98 and global SMEs policy trends	6
Table 3.1	Some social and economic indicators of Ethiopia	83
Table 3.2	Some features of enterprises (as of 1996)	85
Table 3.3	Enterprise/establishment numbers and ownership types (1996/97)	87
Table 3.4	Some characteristics of Ethiopian entrepreneurs (1994-96/97)	88
Table 3.5	Major enterprise start-up and growth problems by enterprise groups (1996/97)	92
Table 3.6	Location and activity based income tax privileges in years (1990)	98
Table 3.7	1992 and 1996 income tax provisions (in years) by enterprise status and location	101
Table 4.1	Strengths, weaknesses and complementing research strategies used in the research	118

Table 4.2	Sample frame summary: number of enterprises established (and/or members of AACCC) between 1992-98 in Addis Ababa	127
Table 4.3	Some features of cases of SMEs	128
Table 5.1	The dynamics of licensing for investment incentives and actual enterprise start ups, 1992-1998 (enterprises size in mil. <i>Birr</i> and number, and ratios in per cent)	138
Table 5.2	Explanations for the difference between investment and employment sizes from pre-licensing to start-up	141
Table 5.3	Regional dynamics of project licensing for the IIS (enterprise number and capital in mil. <i>birr</i> )	143
Table 5.4	Changes in the spatial patterns of manufacturing enterprises: traditional vs IIS-assisted start ups patterns	148
Table 5.5	Regional distribution of revenue foregone from import duties and sundry taxes due to the IIS, 1992-98.	152
Table 5.6	Actual beneficiaries of the IIS support (1992-97)	154
Table 5.7	Summary of some features of the entrepreneurs and enterprises	171
Table 5.8	Acquisition of enterprise site: success and failure stories	174
Table 5.9	Entrepreneurs' knowledge about the level of IIS support	177
Table 5.10	Summary of key enterprise start up decisions: did IIS have an effect?	179
Table 5.11	Customs duty saved and paid: comparing AE1 and UE1	181
Table 5.12	Cost of enterprise site (in <i>birr</i> '000) in Addis Ababa	188
Table 5.13	Agricultural enterprise land costs in Amhara, Oromia and Tigray regions	189
Table 6.1	Objectives and instruments of the IIS and its inferred rationales	198
Table 6.2	Key enterprise start up drives	210
Table 6.3	Investment capital-labour ratios (1992-98).	228
Table 6.4	The efficiency of the IIS take-up (1992-98)	229
Table 7.1	Some enterprise start-up constraints and patterns of coping strategies	254
Table 7.2	Cost of enterprise site in Addis Ababa and rest of Ethiopia	263
Table 7.3	Lead times for enterprise start-up	270
Table 7.4	Business registration and licence fees	272
Table 7.5	Summary of intended and moderated benefits of the IIS	278



# 1. Introduction to the Study of the Role and Impact of Investment Incentives on SMEs Development in Ethiopia

This chapter introduces the nature of and underlying reasons for this thesis. It also briefly introduces the methods used in the enquiry and its findings. Finally, the chapter outlines the structure of the thesis.

## 1.1 The nature of the study

This thesis is about the role and impact of investment incentives on small and medium-sized enterprises (SMEs) start-up and growth in Ethiopia. These SMEs, as defined in chapter two, employed 6-50 people and a minimum of *birr* 250 000 (approximately £25,000) investment in physical assets such as machines and equipment at start up. The investment incentives used to induce enterprise start ups and growth consisted of two main components. Entrepreneurs - or the enterprises they set up - were exempted from paying duties on imported capital goods and income taxes subsequent to the establishment of the enterprises.

Section 1.2 discusses the underlying reasons for the thesis. The discussion begins in 1950 when the enterprise support initiative that this thesis reports on, the Ethiopian investment incentives scheme (hereafter the IIS), was first introduced in Ethiopia. The discussion shows, first, in 1950 Ethiopia was a pioneer in Africa in the use of these incentives to attract foreign direct investment (FDI) in 'modern' industry and hence technology transfer. Second, Ethiopia pioneered again in the early 1960s in using the IIS to support indigenisation of industry and SMEs start ups. However, Ethiopia tried to use the same IIS policy and instruments for this as it had for attracting FDI. Third, at the time when global actors (including those in Africa) were improving their policies on local enterprise and SME development, from 1975-90 the Derg regime in Ethiopia halted private enterprise development, nationalised enterprises and abolished the IIS. Fourth, when the Derg reintroduced the IIS in 1990 the reforms made to the scheme were too little and

too late. The Derg lost power in 1991. The post-Derg period, which this thesis focuses on, was characterised by a move back to the old IIS policies. As in the past, the IIS prevailed as the single most important enterprise support initiative in the country. But the implementation of the scheme learnt little from other countries' experiences, and was insufficiently integrated with other policies to bear fruit.

The thesis, therefore, shows the results of the post-Derg period in Ethiopia, the advances and constraints of the rather narrowly defined IIS policy and instruments, and points to the possible improvements in the future.

Over the period 1992-98, where the empirical evidence for the thesis was collected, the IIS accepted projects from categories of activities referred to as 'pioneer' and/or 'promoted'<sup>1</sup>. With a view to inducing more indigenous start ups, largely SMEs, domestic entrepreneurs were required to deploy a minimum start-up capital of *birr* 250 000 in physical assets like machines and equipment. Foreign capitalists, however, depending on the exchange rates, were required to put in about *birr* 3.5 million. In return, as this study found out, eligible entrepreneurs were offered tax benefits from 5 to 30 per cent of the purchase value of imported capital goods, and an exemption from paying 35 per cent income tax. The period over which entrepreneurs were exempted from paying income tax depended on the location and the nature of the activities of the new enterprises. Accordingly, as details in chapter three will show, enterprises that chose to set up in locations and activity types preferred by the government were given additional income tax exemptions ranging from one to five years.

---

<sup>1</sup> 'Pioneers' refer to activities like irrigation farms and engineering enterprises that have relatively long payback periods. 'Promoted activities' refer to relatively short payback period activities like rainfed agriculture. Pioneer activities commanded more support than promoted activities. Likewise, relatively undeveloped areas received longer periods of income tax exemptions.



This thesis is based on 4246 indigenous projects that obtained an IIS licence over 1992-98, and a follow up in-depth investigation of six cases of SMEs<sup>2</sup>. The period 1992-98 was chosen because there was no reliable data on IIS licensed and assisted enterprises before 1992. Moreover, over 1992-98 the IIS was pursued with vigour for a number of reasons. Most of all the government placed trust in the IIS that it would strengthen the production capacity of enterprises by creating, among other things, differential sector and spatial impacts and spillover effects. The IIS was also used, for example, to signal to indigenous and foreign capitalists that the government was moving away from a socialist system of enterprise organisation that characterised the socialist Derg era. Finally, because IIS's tariff and tax reductions that benefit the private sector were compatible with policies of major donors and creditors like the World Bank, the IIS was at the centre of economic policy measures that the government took with a view to obtaining external development assistance.

## 1.2 Reasons for studying IIS impacts on SMEs development

In much of the literature developing countries' investment incentives are linked with attracting foreign direct investment (FDI) (Asiedu, 2002; Gastanaga, Nugent and Pashamova, 1998, and Cockroft, 1992). In some of this literature FDI is considered as a key provider of investment necessary for capital formation, management and skills often without the obligation of loan repayment. Besides attracting FDI, investment incentives are regarded as a means of increasing competition, positive external economies and spillover effects in a host country (Root and Ahmed, 1979; Gastanaga, Nugent and Pashamova, 1998). However, careful reviews of experiences, particularly from Africa, show some unpleasant

---

<sup>2</sup> Leaving the details to chapter four, the total population of the projects (4246) came from all over Ethiopia and represented the range of activity types that the IIS supported. The selected case studies were drawn from the Addis Ababa region. These were set up during the study period and included three IIS assisted and three non-IIS assisted ones.

outcomes of FDI for the host countries (Cockroft, 1992; Reis, 2000 and Mytelka, 2000): that the technology brought was capital intensive and import dependent; and the balance of payments did not improve due to FDI because outflows in the form of dividends, management fees, and royalties on know-how exceeded the inflow of capital that subsequently resulted in welfare losses.

The concern of this thesis is the impact of investment incentives on indigenous SMEs, an area that the literature has given little attention to. The rest of this section sets out the reasons for studying IIS impacts on indigenous Ethiopian SMEs development. The reasons that emerge from the discussion are based on IIS/SMEs development in Ethiopia and the global SMEs policy developments and trends. The discussion below follows three key periods that define IIS/SMEs development in Ethiopia: 1950-74 (the imperial era), 1974-91 (the Derg era) and the period since 1992 (the post Derg era).

**First, the imperial era (1950-74):** State activism in economic growth and development was vital in Africa in the 1950s and 1960s as there was a need for building the countries that had gained independence with little existing indigenous capital and entrepreneurship. In post independence Africa the industrialization agenda in particular took centre stage of government policy. History showed that industrialisation was an essential part of growth and development, bringing an increase in employment and income and boosting exports (Frimpong-Ansah, 1992; Stewart *et al*, 1992; Jenkins, 1992; Mytelka, 1988). The type of industrialization that African governments adopted was mass production industrialization based on large scale factory production (Mytelka, 1988)<sup>3</sup>. At the time the prevailing economic doctrine also justified mass

---

<sup>3</sup> The pursuit of this strategy resulted in widely debated and recorded consequences including de-industrialisation of African manufacturing, agricultural crisis and debt crisis (see, among others, Riddell, 1990; Stewart, Lall and Wangwe, 1992; Frimpong-Ansah, 1992 and on Ethiopia, Berhanu Abgaz, 1994).



production industrialization that came about through increased investment particularly in new machines and equipment and often via FDI. In short, mass production industrialization was thought to provide the advantage of positive economies of scale and labour specialisation (Sengenberger, Loveman and Piore, 1990).

The industrialization logic and process in Ethiopia, which started after the Italian occupation of 1935-41, were largely similar to the rest of Africa (IGE, 1955 and Eshetu, 1994). As part of its industrialization drive Ethiopia introduced the investment incentives scheme in 1950 (IGE, 1950). The key objective of this scheme, as shown in Table 1.1, was to induce foreign investment, technology, skills and management in the manufacturing industry. The incentive instruments used were exemptions from the payment of custom duties on imported machinery and income tax. The incentives, by inducing the use of modern and capital intensive machines and equipment, were meant to increase the size of establishments. Size of an establishment, in turn, was thought to be positively linked with high productivity (IGE, 1955: 17). Following the adoption of the scheme a handful of enterprises (like the Wonji Sugar factory and Ethio-Japanese Textile Share Com) were established with the participation of foreign capital (Schwarz, 1968) along what is now known as the Addis Ababa-Nazareth corridor (hereafter the corridor).



**Table 1.1 Mapping changes and continuity in the use of the instrument of investment incentives in Ethiopia during 1950-98 and global SMEs policy trends**

pointers	Imperial era: 1950-1974 (Ethiopia as a pioneer)	Derg era: 1974-1991 (Ethiopia slips)	Post Derg era: 1992-1998 (no learning from others)
IIS policy objectives	<b>1950-63:</b> induce <i>foreign</i> investment, technology transfer and management in mainly large scale manufacturing enterprises and big corporations (IGE, 1950). Ethiopia was ahead of the game in Africa.	<b>1974-90:</b> IIS discontinued (PMGE, 1975a and 1975c)	<b>1992-96:</b> IIS reintroduced to induce more jobs, increased domestic and foreign investment, and balanced regional development, etc. Several new/major expansion industry areas were opened for private sector development (TGE, 1992).
	<b>1963-74:</b> IIS reformed to induce private <i>domestic</i> and foreign investment and technology in new and major expansion projects in manufacturing, agriculture, transport and tourism (IGE, 1963 and 1966).	<b>1990-91:</b> IIS reintroduced in 1990. Objectives included increasing domestic resources use, introducing science, technology and know-how, creating employment and balanced inter-regional development. Sectors included new/major expansion projects in manufacturing, agriculture, agro-industries and hotels (PDRE, 1990)	<b>1996-98:</b> objectives as in 1992-96 above (FDRE, 1996a and 1998b)
IIS policy instruments	<b>Type:</b> exemptions from the payment of custom duties on imported machinery and income tax. <b>Bias:</b> over 1950-63 in favour of foreign owned large manufacturing enterprises. In the 1960s entry requirement for <i>domestic</i> investors was lowered.	<b>Type:</b> over <b>1990-91</b> exemptions from the payment of custom duties on imported machinery and income tax. <b>Bias:</b> (1990-91) in favour of smaller indigenous and productive sector enterprises, and less developed regions	<b>Type:</b> exemptions from the payment of custom duties on imported machinery and income tax. <b>Bias:</b> in favour of smaller indigenous productive sector enterprises and less developed regions.
Ethiopia's and global economic management context	<b>National:</b> selective state intervention policy, series of five year development plans.	<b>1974-90:</b> socialist economic policies guided by central planning. <b>1990-91:</b> mixed economic policy (UNIDO, 1991).	Stabilisation and liberalisation, private sector development and decentralisation (Befekadu and Berhanu, 2000)
	<b>Global:</b> some interventionist state policies and mass production industrialization paradigm including in Africa (Mytelka, 1988; WDR, 1997)	Resurgence of neoliberal economic policies (along with some interventionist state policies e.g. in Eastern Europe and SSA) (WDR, 1997).	Consensus that state and market complement each other (Schulpen and Gibbon, 2001).
Global SMEs policy trends	In many countries SMEs were regarded as less important units (Sengenberger, Loveman, and Piore, 1990)	Re-emergence of SMEs and spread of SMEs policies and institutions (Sengenberger, Loveman, and Piore, 1990; Pedersen, <i>et al</i> , 1993; and Rogerson, 2001)	SMEs policies and institutions like Scottish Enterprises (McQuaid, 1997) & SMEs development in SSA (ADR, 1997 and Rogerson, 2001)

Source: own construction

The 1950 investment code did not allow indigenous enterprises to draw benefits from the incentives scheme. The neglect of the emerging indigenous enterprises and entrepreneurship, and issues around indigenising enterprise management were hence raised as concerns that might stifle sustained industrialization in Ethiopia (Teferra, 1959: 33-34). In line with such arguments, it seems, reforms were made to the IIS code (IGE, 1963 and 1966). The new codes aimed to assist indigenous (largely small) enterprises in the manufacturing and non-manufacturing sectors of the economy. This policy development was an important step in recognising the roles of SMEs in the industrialization process particularly at a time when SMEs were generally considered as marginal contributors to growth and were hardly the subjects of policy debate (Sengenberger, Loveman, and Piore, 1990).

**Second, the Derg era (1974-91):** The momentum for enterprise development and attracting foreign investment was halted by the Derg government that nationalised enterprises and abolished the investment incentives scheme (PMGE, 1975a and 1975c). Subsequently Ethiopia fell under the category of ‘hostile’ and ‘problem’ countries for FDI for most of the 1970s and 1980s (WIR, 1994: 93 and Helleiner, 1992: 55)<sup>4</sup>.

While private enterprise development was on hold in Ethiopia, the period from the late 1970s through the 1980s saw the resurgence of neoliberal economic policies and alternative models to the mass production industrialization. As part of the latter, new theory and evidence (that came under the rubric of ‘flexible specialisation’) put SMEs at the centre stage of the industrialization debate both in developed and developing countries (Piore and Sable, 1984 and Pederson *et al*, 1993). It was argued that flexible and affordable technologies, and the lean and

---

<sup>4</sup> Shortly before its fall in 1991 Derg reintroduced the IIS, and the content of the new reform was largely adopted in the 1992 IIS code (Table 1.1).



flexible organisation of SMEs have made these units withstand recessions and become net contributors to employment, innovation and growth (Sengenberger, Loveman, and Piore, 1990). To take advantages of these strengths institutions and wide ranging support initiatives (like business advice and finance) were devised (Sweeney, 1997). In some countries efforts towards promoting FDI were combined with local enterprise development<sup>5</sup>. SMEs role in Africa's industrialization and development also shifted from 'policy periphery' to occupy an increasingly more central role (ADR, 1997 and Rogerson, 2001:115).

**Third, post Derg era (1992 and after):** As part of the structural adjustment programmes (SAP), Ethiopia brought in legislation that offered a wide range of measures including incentives, institutional structures to coordinate FDI, and processes that simplified the approval for investment and profit repatriation (TGE, 1992). The 1992 IIS code, like the 1990 one, aimed to pursue objectives including increased domestic resources use, introducing science, technology and know-how, creating employment and balancing inter-regional development (see Table 1.1). The scheme also aimed to assist new and major expansion projects in manufacturing, agriculture, agro-industries and hotels. By lowering the entry requirement into the scheme, the policy favoured smaller indigenous and productive sector enterprises and less developed regions. The instruments of incentives, however, remained exemptions from the payment of custom duties on imported machinery and income tax. Moreover, apart from the IIS, policy measures contained in SAP barely brought any initiatives towards enterprise development (like entrepreneurship development, enterprise finance and access to land). The IIS, however, outside its remit and in an uncoordinated manner,

---

<sup>5</sup> In Scotland, for example, the Scottish Development Agency (later Scottish Enterprise) was set up to conduct diverse objectives such as the promotion of new ventures, attraction of inward investment and improving the export performance of enterprises (MaQuaid, 1997: 201).

started to address some of the constraints to enterprise development such as access to enterprise sites.

To summarise, therefore, the Ethiopian IIS system was an innovation in Africa when it was introduced 1950. However, when IIS was reintroduced in the early 1990s it had not moved on.

The above historical account of IIS/SMEs development in Ethiopia (which was drifting away from the global SMEs policy and institution development) raises several concerns that this thesis seeks to addresses:

*First, the Ethiopian investment incentives scheme lacked learning from own and others' experiences.* Clearly the IIS prevailed as a key government policy towards assisting enterprise development in Ethiopia. The original (1950) IIS objectives and instruments were compatible with the underlying economic doctrine that equated industrialization with capital formation through large scale/capital intensive investment only supplied by FDI. In this regard the IIS was an innovation. However, as the role of SMEs became widely recognised since the 1970s, enterprise development in Ethiopia was either suppressed or stagnated in the number and type of instruments of support. As the IIS was successively reintroduced (in 1990, 1992 and later) it was meant to promote multiple objectives (like increasing jobs, investment and regional development) with the same limited instruments of exemption from paying duties and income tax. The consequences of these developments were that:

- (i) by drawing on scarce resources and the attention of policy makers, the IIS limited the scope for developing other enterprise support initiatives.



- (ii) over time the IIS has become a mythical device for enterprise development in that, without any substantive evidence, it has been believed to have created, among other things, industry and spatial impacts<sup>6</sup>.
- (iii) assigning the role of promoting indigenous enterprises through the Ethiopian Investment Authority (EIA) which was meant to attract FDI, has also caused some problems. For example, the set up of a reserve schedule and lower entry criterion for indigenous enterprises discriminated against smaller size foreign enterprises that would have been sources of capital and skills transfer.

*Second, can tax based investment incentives influence entrepreneurial decisions such as choices of industry and location.* The main economic reason behind investment incentives is that by reducing the cost of investment at start up and/or increasing the potential for earning profits, investment incentives influence entrepreneurial decisions in favour of particular features of an enterprise such as its industry and location (WIR, 1994 and UNCTAD, 1996). However, the theory barely considers circumstances that influence entrepreneurs' behaviours, such as their resource base, education levels, and social and psychological features that influence the take up rates and uses of incentives. Evidence from Borin *et al* (1994) and this thesis demonstrate that many entrepreneurs in Ethiopia are less flexible between industries and locations, among other things, due to constraints of physical infrastructure and financial resources. This means that investment incentives barely benefit SMEs that many researches regard as more likely units to ensure local ownership and control and create considerable opportunities for employment, income distribution, spatial development and industrialization in LDCs (see, among others, McCormick, 1993; Cortes *et al* (1987)).

---

<sup>6</sup> As chapter three will show, with the exception of Schwarz *et al* (1968), the impacts of the IIS had hardly been studied. Even the Schwarz *et al* study was methodologically flawed and out of date.

The above concern is supported by studies, albeit limited, that show that the impact of investment incentives on enterprise development was contested. In developing countries such as Ghana, Argentina and India where duty and income tax exemptions prevail these instruments neither sufficiently influenced entrepreneurial decisions nor promoted government objectives (Ingram and Pearson, 1981; Borello, 1995 and Subrahmanya, 1998). However, impacts of investment incentives in developed countries were much more positive. For example, for some enterprises they were an important influence to locate in assisted areas (Allen, *et al*, 1986 and Giaoutzi *et al*, 1988).

*Third, investment incentives are likely to undermine indigenous technological capability building:* Evidence suggests that investment incentives encourage the import and build up of physical assets such as machines and equipment that tend to be underutilised and less linked with domestic resource use (Mulatu, 1982 and Cockroft, 1992). Moreover, inducing the import of capital goods is likely to undermine indigenous technological capability development - that is learning the technology, its specification and design, process, making use of local resources, relevant to local environment and demand - factors that many regard as more important than a mere acquisition of production techniques (Mytelka, 1992; Najmabadi and Lall, 1995 and Forbes and Wield, 2000).

The above issues form some of the central arguments of the thesis. Moreover, as already stated, the thesis used 4246 IIS licensed projects and the in-depth investigation of six selected case SMEs. Among the reasons considered for thoroughly investigating IIS impacts on SMEs was the fact that IIS assistance was increasingly extended to small and medium-sized projects. The IIS applied to enterprises that employed a minimum of *birr* 250 000 at start-up. Almost two in three of the 4246 projects had proposed capital investment of less than *birr* 500 000. Moreover, at start up more than 80 per cent of the enterprises employed less



than 50 people. These meant that, by the very nature of the size distribution of Ethiopian enterprises, most of the IIS clients were SMEs<sup>7</sup>. However, relatively larger projects with proposed capital investment more than *birr* 5 million accounted for less than 20 per cent of the total IIS licensed projects. As to micro enterprises, these could not have been selected because over 1992-98 the IIS structure systematically bypassed enterprises that employed capital less than *birr* 250 000<sup>8</sup>.

In the size structure of Ethiopian enterprises, SMEs are strategically positioned between micro and large enterprises<sup>9</sup>. By studying the process of SMEs start-ups and growth, and the IIS impacts thereon, this study was able to uncover economy-wide enterprise development constraints and opportunities. Moreover, as supported by theory and evidence discussed in chapter two, SMEs have distinctive strengths particularly in generating and maintaining jobs. Hence the thesis makes a case in favour of supporting SMEs development, far more effectively than through investment incentives, because these units serve as an

- 
- <sup>7</sup> Evidence from other less developed countries (for example, McCormick (1993) on Kenya) shows that SMEs have low representation in the size structure of enterprises. Clearly the criteria used to define enterprises across countries have influence over such a conclusion. However, contrary to such evidence, Ethiopia tends to have a relatively higher representation of SMEs. For example in mid-1990s Ethiopia had 2731 small and 642 medium and large manufacturing enterprises (CSA, 1997e and 1997b). This means that well over 80 per cent of Ethiopian manufacturing enterprises were SMEs. There was a similar size structure in the IIS licensed projects as well as IIS assisted start ups. A great many IIS assisted start ups were small (or at best medium) enterprises that were in footwear, oil extracting and flour mill industries and employed one plant/product line operation.
- <sup>8</sup> There were other, more personal, reasons for undertaking this study. These include my interest in the development of the Ethiopian enterprise sector and its support initiatives. My interest in this area, which provided strong motivation for studying the IIS in Ethiopia, emerged from the issues and questions confronting me when I was working as an economic and social development policy analyst in Ethiopia over the period 1985-95.
- <sup>9</sup> In common use of the language, in Ethiopia 'business' meant running such activities like a corner shop or a restaurant but not a manufacturing or engineering enterprise. Conversely a 'firm' referred to a manufacturing or engineering enterprise. In this thesis I consider the role and impact of the IIS on all kinds of enterprises that met the IIS criteria. Therefore, I have used a less confusing term 'enterprise' to mean both 'business' and 'firm'.



engine to transform the fragile agriculture-based economy of Ethiopia into a more dynamic enterprising economy.

Finally, the thesis also links IIS on the one hand and SMEs start-ups and early growth on the other. These links were, again, caused by the nature of the IIS assistance to enterprises. IIS incentives that came in the form of duty and income tax exemptions were targeted at enterprise start-up and early growth stages, respectively. However, the thesis put some limits to the kinds of start-ups it considered. First, although some major expansion programmes and foreign direct investment (FDI) did benefit from the IIS, these were not considered in this thesis as they constitute only a small fraction (under five per cent) of IIS assisted projects<sup>10</sup>. Second, enterprise start-ups through spin-offs and franchises were not studied as neither of these two was characteristically common to Ethiopia. Third, the informal sector operates largely underground and so did not benefit from the IIS, hence these businesses were not studied. Fourth, with the view to focusing on the role and impact of the IIS, the units studied received no official assistance (government or otherwise) except from the IIS. Finally, this study did not aim to evaluate the entire IIS. The IIS had a range of objectives like export promotion but, as discussed earlier, it had only limited means to promote those objectives. This enquiry, therefore, focused on areas where objectives had a means of implementation as in incentives to influence entrepreneurs' choices over sector, location and size of enterprises.

### **1.3 Research hypotheses and questions**

Policy makers in Ethiopia were convinced that investment in physical assets (particularly the acquisition and adoption of new machines and equipment) would serve as an engine of growth, industrialization and spatial distribution of

---

<sup>10</sup> Over 1992-98 the IIS succeeded in granting licences to 129 foreign projects or investors compared to 4246 indigenous ones.

wealth. The authorities hence provided investment incentives, as outlined above, to induce enterprise start-up in 'preferred' locations and 'pioneer' and 'promoted' activities. The main research problem of this study was, therefore, to explore the validity of the assumption that the IIS influences entrepreneurial choices of type, location and size of enterprises.

At the early stage of the development of this thesis, the preliminary evidence generated and reported in chapter four showed that in Ethiopia enterprise start-up crucially depended on, among other things, the attributes of entrepreneurs (including their number, financial resources, awareness level of enterprise assistance provided), market and available infrastructure. Hence, with regards to the role assigned to the IIS, I anticipated a rather limited impact as summarised in hypothesis one (H1):

- H1: the influence of investment incentives on the timing, type, location and size of IIS assisted SMEs was limited.

Although I expected that investment incentives played a limited role, in the course of my in-depth field study of IIS assisted SMEs start-ups, I observed an unintended but more important function of the IIS. This unintended function of the IIS was related to two fundamental enterprise start-up problems: that, first, entrepreneurs had problems of access to state controlled and allocated resources like land and bank credit. And, second, entrepreneurs faced enormously complicated procedures of business legalisation. Both these circumstances were unacceptable to the entrepreneurs. However, my argument began, in return for some tolerance or acceptance of the legitimacy of government control particularly over land, some IIS licence holders were provided privileged access to key enterprise start-up resources. I encapsulated the gist of this argument in hypothesis two (H2):

- H2: some entrepreneurs sought the support of the IIS, in addition to its fiscal incentives, for its role as a gateway to resources (land, credit and utility)



required for enterprise start-up, and to ease the otherwise bureaucratic business legalisation processes.

In addition to exploring the foregoing hypotheses<sup>11</sup>, the research raised several questions for investigation at national, regional and enterprise levels. These questions included: what were the rationales for the IIS, and what direct and indirect benefits (and costs) did the IIS cause to entrepreneurs and the society? What enterprise start-up and early growth constraints did the entrepreneurs face, and how did the IIS help them to overcome these constraints? And how did IIS benefits influence (if they did) entrepreneurs' decisions over the choices of the type, location and size of the new enterprise? Here the notion of influence was conceptualised as entrepreneurs actively seeking and using IIS assistance in their decision to start-up an enterprise.

At the centre of the foregoing research hypotheses and questions was the role and impact of the IIS on SMEs start-up and growth. Hence these hypotheses and questions led to the pursuit of the following objectives:

- to review and evaluate influential literature on SMEs and thereby identify strengths of and rationale for promoting them;
- to identify the rationale for and objects of investment incentives as means of promoting enterprise development;
- to describe and analyse the Ethiopian enterprise economy and thereby show enterprise development opportunities and constraints, and discuss policy initiatives towards the enterprise sector (focusing on IIS/SMEs);
- to identify and develop the methodology for the enquiry;

---

<sup>11</sup> H1 and H2 focus on the role and impact of the IIS on three dimensions of enterprise start up, that are the choices of industry, location and size. Note that in the hypotheses the timing of enterprise start up is considered as an implicit outcome/impact of the IIS. Two dimensions of time are built into H1 and H2. The first is where the IIS influences an entrepreneur as a source of motivation to start up an enterprise sooner rather than later (this is dealt with in H1). And the second dimension of time is where IIS assists entrepreneurs, who have already started implementing a project, to cut the lead time to start an enterprise (this is discussed along with H2).

- to discuss and evaluate whether the IIS has influenced entrepreneurial decisions over choice of the type, location and size of enterprises;
- to discuss and show how the IIS served as a gateway to resources and eased bureaucratic procedures;
- to provide recommendations for the development of the Ethiopian enterprise economy.

To meet these objectives, explore the hypotheses and answer the questions set out above, the development of the thesis was firmly based on the conceptual framework and methodology outlined below.

#### **1.4 Conceptual framework and methodology**

The conceptual framework developed and employed in this thesis followed the approaches by Miles and Huberman (1994) and Blackmore and Ison (1998). The main purpose was to determine the boundary of the core area of the study. Hence, at the heart of the study, and this framework, were the IIS and the entrepreneurs it induced to set up enterprises (as shown in Figure 1.1). Figure 1.1 also shows:

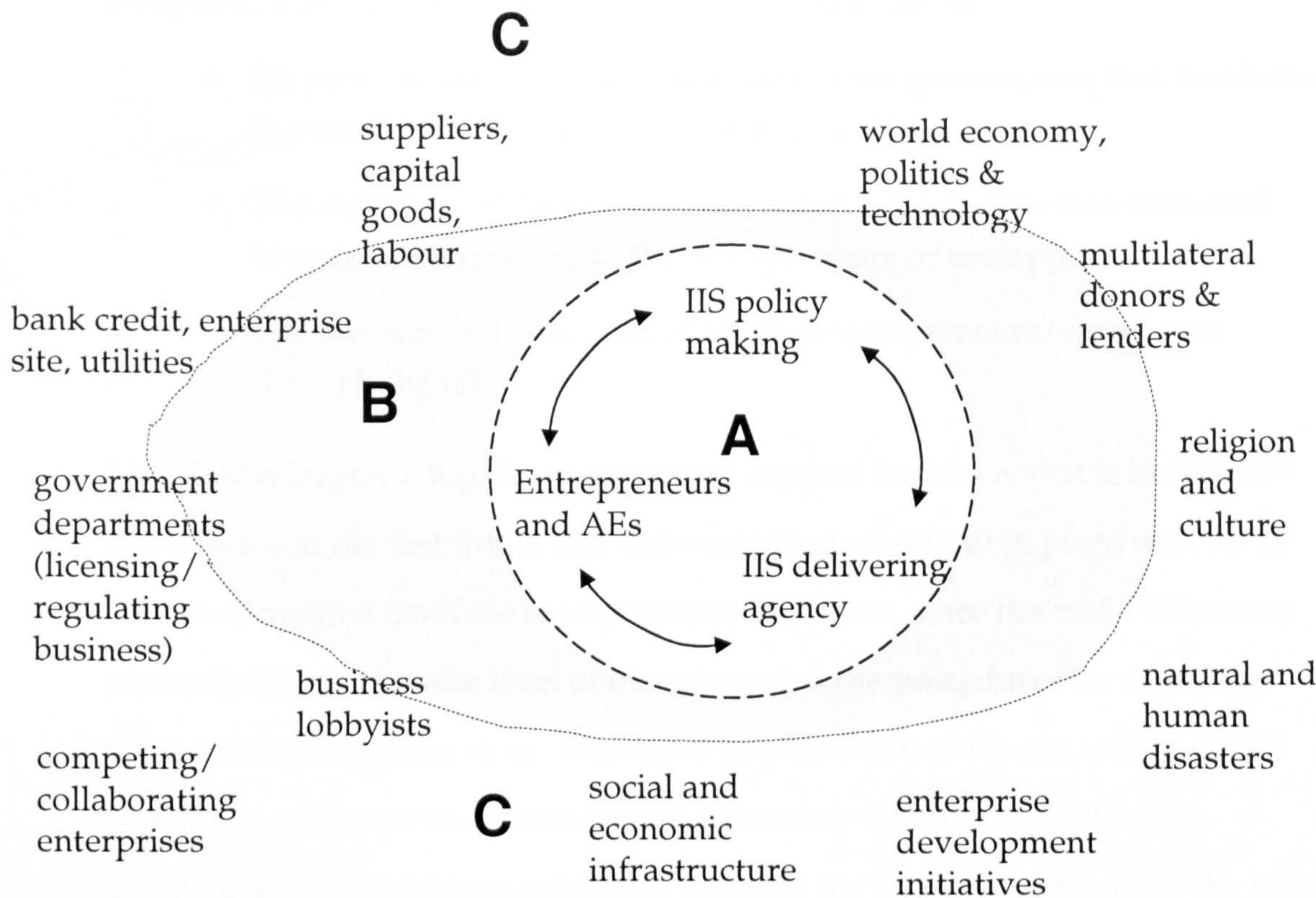
**First, the environment for enterprise development (labelled C):** this environment is made up of forces that impinge on the role and impact of the IIS and the enterprises it assists. These forces, however, are numerous to list and it is difficult to establish their relationships and measure their relative influence over the IIS and assisted enterprises (AEs). However, this whole system includes: (i) forces close to AEs - these are suppliers of capital goods, labour, credit, enterprise site, competing and collaborating enterprises, and linkages that exist between these enterprises. (ii) social and economic infrastructure and institutions like skills training institutions and roads, non-IIS enterprise support initiatives and federal/regional level government departments that license and regulate businesses. (iii) factors profoundly built into the cultures, religions and psychology of Ethiopians that motivate or inhibit entrepreneurial development and impinge on the nature of goods and services produced and consumed. And

(iv) forces that seem distant to the IIS and enterprises but still affect enterprise development, including world politics, economy and technology, human and environmental disasters. This whole system provides the positive and negative incentives for enterprise development.

The degree to which the elements of the environment were studied and reported in the thesis varied depending on the expected impacts of these forces on the IIS and the AEs. Accordingly, some elements of (i) and (ii) above, and forces that emerge from, and are very much intertwined with government enterprise policies, the history, culture, religion and geography of Ethiopia and that impact of the IIS and AEs were carefully selected and reported in the thesis. In short, the review of literature on theory and practice of enterprise start up (notably SMEs), and the study on Ethiopian enterprise economy have examined the extent to which this whole system environment (C) supports the success of the IIS in inducing enterprise start up.



**Figure 1.1** Framework of environment for enterprise development, the investment incentives and enterprises start up systems



**Legend:**  
A shows the core IIS system boundary  
B is the extended IIS system boundary, and  
C is the whole environment for enterprise development.

**Second, the IIS system (labelled A):** The IIS is a sub-system of the whole system for enterprise development. It was a deliberate creation of the government to induce entrepreneurs to set up enterprises in selected areas and believed to have contributed to the overall development of enterprises. The IIS system has clearly marked boundaries as entry into the system was based on criteria defined by regulation or law. Accordingly, entrepreneurs who positively perceive the screening process for incentives and pass the eligibility criteria, as required by



regulation, enter into IIS system. The Ethiopian Investment Authority (EIA) and regional investment offices grant entrepreneurs an investment licence, and the units (in the terminology of this thesis) became AEs. It follows, therefore, that the IIS system was made up of three inter-linked components:

- IIS policy making domain - the body of the government that decided on the role and contents of investment incentives.
- The institution (EIA and regional investment offices) that delivered investment incentives to the entrepreneurs or enterprises.
- The domain that consisted of assisted entrepreneurs/enterprises through the IIS.

The IIS was largely a top-down enterprise support initiative, that is investment incentives and the institution that delivered them were put in place with no or little participation from the entrepreneurs. However, since the mid 1990s some piecemeal changes to the level of incentives and the procedures for acquiring them were taking place in an interactive way between the forces within the IIS system. To reflect on this development a two way relationship (although admittedly weak) was conceptualised between the three components of the IIS. The IIS system, therefore, constituted the core area of the thesis, and the exploration of hypothesis one (H1) rested on this system.

**Third, a redrawn or extended boundary for the IIS system (labelled B):** As stated above, the core IIS system boundary (A) was closed to entrepreneurs/enterprises that did not meet the entry criteria for the scheme. However, over the course of my ground level study I discovered that the IIS system provided benefits that were not essentially part of the system. In this sense, therefore, the IIS system was open outwards and assisted AEs to draw some benefits from elements of the



environment outside the IIS core boundary (A)<sup>12</sup>. These external benefits that AEs drew on emerged from resources controlled and allocated by the government and its institutional support. Hence it was essential to reconceptualise IIS's role and boundary. From this re-drawn IIS boundary (shaded area B) some AEs got easy and/or free access to enterprise site, better access to energy source and bank credit, and easier enterprise licensing procedures. Even access to foreign exchange (allocated by the government including that originally supplied by multilateral donors like the World Bank) was made available on a priority basis to AEs so that the money could be used to purchase capital goods.

Moreover, it was conceptualised that the forces that determine the boundary of B were both within and outside the IIS system (A). However, the most potent forces that shape this boundary (B) were the entrepreneurs and the AEs<sup>13</sup> themselves. To generate benefit outside the IIS system, the entrepreneurs primarily targeted areas where property rights were controversially set and/or vaguely defined (for example in land). AEs then used multiple strategies (like acknowledging the government's controversial stance over the ownership and allocation of land, lobbying or seeking favour through unethical practices like bribery) to reap the benefits. The precise content of AEs non-IIS benefits, therefore, partly depended on the attributes and resources of the entrepreneurs. For example, entrepreneurs that were better educated made better use of information about laws and regulations related to such resources as land. Hence, unlike the core IIS boundary

---

<sup>12</sup> To show this outward openness the boundary of A is marked by broken lines. Also note that the boundary of B disproportionately incorporates resources and institutions owned and/or managed by the government.

<sup>13</sup> Changes in the boundary between the firm and its environment is not new. Amendola and Bruno (1990) theorised and observed constantly changing boundaries of the firm especially at a time when the firm undergoes radical innovation. According to Amendola and Bruno the firm chooses a deliberate strategy that takes elements of the external environment as part of its activity - in other words the firm *internalise* part of the external environment. Chataway and Wield (1994) expanded on this with a similar approach.

(A), the boundary of B was loose, and to denote this looseness a boundary that was irregularly shaped and made of small dotted lines was put round it.

Many AEs' strategies for acquiring key enterprise start up resources and the benefits thereof were associated with the IIS. These non-IIS AEs benefits, as I will base this argument on hypothesis H2, had profound impacts in terms of the pace of enterprises start up and the choice of location and size of some enterprises. Moreover, exploring the complex political, economic and social forces that changed the core IIS boundary in itself has become an interesting part of the thesis. The exploration of H2 focuses on three most important areas to the entrepreneurs: access to enterprise site, energy and credit sources.

To sum up, from this description and discussion, it follows that boundaries A and B and the forces that influence them were the primary focus areas of the thesis. As will be reported in chapter four, the conceptual framework, that specified these core areas of the study, helped to identify the nature and location of data, review theory and practice on SMEs development, and construct background literature on the Ethiopian enterprise economy.

Answers to the questions and exploration of the hypotheses of the study required reasonably adequate and reliable data. However, such data on Ethiopian enterprises were scarce. Moreover, the heterogeneous nature of SMEs and poor physical infrastructure of Ethiopia have severely limited collecting survey based data. The conclusions of the thesis are, therefore, based on a wide range of data that include macro statistics (particularly that showed the regional distribution of enterprises and IIS licensed projects and start ups), past survey results and selected case of SMEs. These sources produced data that were complementary in that each source confirmed or challenged the conclusions which emerged from the other. Data were obtained through interview questionnaire and desk study.

Also because of the nature of the enterprises studied and the context of the study, in the thesis theories from different disciplines were used. The dominant rationale for investment incentives is economic - that is entrepreneurs get motivated by incentives and start up enterprises in a particular location or industry because these incentives reduce start up costs and/or increase the potential for making profits. However, the economic logic behind incentives was found inadequate because it does not explain, for example, the social and psychological reasons of entrepreneurs for starting up enterprises. Hence theories drawn from the disciplines of economics and social-psychology were used to identify the complex factors that motivate SMEs founders (such as the motives for profits, need for independence and/or achievement). Moreover, literature that showed strengths of SMEs, among other things, in job creation and concerning the rationales for assistance (including through the provision of investment incentives) were used. The context of this study (particularly location and industry aspects of IIS impacts on the start up of SMEs) has also influenced the selection and use of strands of theories from industrial economics and spatial studies.

### **1.5 Major findings and the big picture of the study**

Drawing on theory and the empirical evidence generated for the study, the thesis found that, in the main, enterprise start-up and entrepreneurs' decisions on the type, location and size of enterprises were triggered and caused by the attributes and resources of the entrepreneurs and the socio-economic environment including institutional sector entry barriers. More specifically the thesis found that, first, the increase in the number of enterprise start-ups in the 1990s was, among other reasons, due to the end of the civil war and the introduction of a better enabling environment. Second, for many SME founders formal and informal training, accumulated experience and interest in the chosen sector, the threat of unemployment and market opportunities were some of the factors that provoked start-up in a particular activity type. Third, the IIS did not influence



entrepreneurs' location decisions because IIS benefits were too small to compensate for costs like loss of central market and infrastructure.

However, the thesis found that the IIS positively influenced enterprise size at start-up due to, first, duty exemptions which increased savings to the entrepreneurs by up to 13 per cent of the total cost of machinery. And second, with a view to meeting IIS entry criteria, some of the entrepreneurs studied increased the start-up capital of their enterprises.

To sum up, structural deficiencies such as entrepreneurs being resource poor, and inadequate physical infrastructure, made the IIS a less effective enterprise support initiative. Consequently, the huge government revenue foregone (over 1992-98 this was *birr* 526 million from duties alone) on subsidising start-ups was largely ineffective. Moreover, most of the IIS direct and indirect benefits accrued to enterprises that were least likely to require government support to choose a particular activity and location. Therefore, hypothesis one was fully supported, that is that the influence of investment incentives on the timing, type, location and size of IIS assisted enterprises was limited. And the conclusion that emerged was that the assumptions that the IIS influenced entrepreneurs' decisions on the choices of sector and location were deeply flawed.

The study, however, found that the IIS licence was more useful to the holder when used, not as a device for investment incentives as originally intended, but as a moderator of access to state controlled resources like enterprise sites. It was found that entrepreneurs with subsidised access to an enterprise site saved about 18 per cent of the total enterprise start-up cost, higher than the 13 per cent savings from imported machinery. Furthermore, owing to institutional support some IIS assisted entrepreneurs considerably reduced the lead time for acquiring these state controlled resources. Therefore, hypothesis two was also supported: that some entrepreneurs sought the support of the IIS, in addition to its fiscal

incentives, for its role as gateway to resources (like land and bank credit) required for enterprise start-up.

However, for reasons given later, part of H2 that referred to IIS's role as 'easing the bureaucratic business legalisation processes' was not proved correct.

To conclude, what objects the IIS did or did not influence constituted only part of the story of this thesis. As will be shown in concluding chapter eight, the bigger picture of the thesis emerges from a critical re-examination of the reasons why the IIS proposition was flawed and why it mediated access to resources. It emerges that the IIS was neither sufficiently coordinated with other enterprise support initiatives, nor primarily considered the needs, potentials and constraints of the entrepreneurs. In short the scheme was too prescriptive and attempted to address multiple objectives with inadequate means.

The thesis, therefore, suggests a major change in the thinking behind using an investment incentives scheme as a device for enterprise development. This change needs to recognise that encouraging physical capital accumulation, albeit important, is not everything for the development of the enterprise sector. Enterprise support initiatives should focus on the key driving forces of enterprise development, such as developing entrepreneurs' technical and managerial skills, providing better access to land, finance and infrastructure, and providing streamlined procedures for business legalisation.

A brief structure of the thesis is set out below.

## 1.6 Structure of the thesis

Following this introduction, chapter two provides the theoretical foundation of SMEs promotion and start ups. Focusing on recent developments in the SME literature, and instruments of investment incentives, the chapter deals with concepts and reasons for promoting enterprises. The core of chapter three is the

Ethiopian enterprise economy and the investment incentives scheme (IIS). In chapter three recent developments of the enterprise economy, its structure, linkages, constraints and institutions that provide support (like the IIS) are discussed. Chapters two and three combined set the background for the development of the subsequent chapters.

Chapter four outlines the reasons as to why and how different sources of evidence were used in the thesis. Moreover, the chapter explains the data collection and analysis methods used. Finally, the chapter describes how the fieldwork was conducted and the problems faced.

Chapter five documents the main findings of the enquiry into the roles and impacts of the IIS on SMEs development. These findings were based on enterprise level qualitative and quantitative data, macro level statistics, and extensive interviews with authoritative personalities on the enterprise sector of Ethiopia.

Chapter six discusses and evaluates the impact of the IIS on enterprise start-up. Based on hypothesis one (H1) of the thesis the chapter explores objects of investment incentives (enterprise start-up and entrepreneurial decisions over the type, location and size of an enterprise) and whether these were influenced by the IIS. Chapter seven, based on hypothesis two (H2) of the thesis, discusses IIS's unique role in enterprise start-up resource mobilisation and business legalisation.

Chapter eight provides the summary and conclusion of the thesis. The chapter draws out the bigger picture of the thesis and makes recommendations. Finally contributions and original claims of this thesis and directions for further research are outlined.



## **2. The Theoretical Foundation of Promoting SMEs Start-ups and Growth with Emphasis on the Instrument of Investment Incentives**

### **2.1 Introduction**

The subject of this thesis is the role and impact of investment incentives on enterprises, notably SMEs start-up and growth. In particular the thesis looks at whether investment incentives have influenced entrepreneurs' decisions over the timing of enterprise start-up and the choices of type (or industry), location and size of enterprises.

The literature reviewed in this chapter is closely tied in with the subject of the thesis and falls into four broad categories. The first category addresses the theoretical and empirical literature that discusses the re-emergence of SMEs out of the shadow of large enterprises over the past three decades. Among the extensive literature in the area I have identified and examined those that (i) were most influential in terms of providing the rationales for assisting SMEs; (ii) those that were most identifiable with SMEs development in less developed countries (LDCs). Section 2.2 below covers this first part of the literature review.

The second theme of the chapter is the rationales for and objects of investment incentives as a means of promoting enterprise development. Based on this theme, section 2.3 examines the role and meaning of and rationales for investment incentives. The section particularly addresses the key factors that investment incentives are expected to influence. Section 2.4 deals with the third theme of the chapter which looks into the broader factors (other than investment incentives) that influence entrepreneurs' decisions over the location, type and size of the new enterprise. In addition, and in line with the second hypothesis of the thesis, section 2.4 reviews the literature on how state and business interest group interactions impact on enterprise start-ups and development.

The fourth theme of the chapter is the actual performance of investment incentives in terms of enterprise start-up and growth in different countries. In assessing the performance of investment incentives, section 2.5 takes into account earlier discussions on investment incentives and the broader factors that impact on enterprise start-up and growth. Finally, by bringing together the key points that emerge from the four major themes of the chapter, section 2.6 concludes the literature review on SMEs and investment incentives. Section 2.6 also makes connections with the key hypotheses and questions of the thesis. The literature reviewed under the above four broad categories or themes aims to show the trend in the development of the SME literature and support initiatives.

## **2.2 Theory and evidence on the re-emergence of the SME sector**

The section begins (in 2.2.1 below) in the early 1970s when SMEs are believed to have 're-emerged'. At the outset, note that by SMEs 're-emergence' it was meant not that these units made a comeback from extinction, but that their relative importance had increased with regard to certain essential qualities like job creation, competition and innovation. Section 2.2.2 discusses the key literature most identifiable with SMEs development in LDCs. Finally section 2.2.3 further examines the agencies and rationales for promoting SMEs development.

### **2.2.1 Did the SME sector re-emerge?**

Following the Fordist model of production, consumption and organisation, until the early 1970s enterprise size was increasing to take advantage of positive economies of scale and specialisation of labour. However, according to wide-ranging sources, during the 1970s an 'important reversal in the size structure' began to occur - that is production and employment were concentrating in the

SME sector (Storey and Johnson (1987), Sengenberger, Loveman and Piore, (1990), OECD (1993) and Curran (1999))<sup>14</sup>.

How significant was this claim and what explained the comeback, if there was one, of the SME sector? These questions are carefully examined as there were widely divergent views on the actual and potential contributions of SMEs. Some of the claims, as Curran (1999) observed, attempted to 'oversell' SMEs' contributions. Others were sceptical about the role of and evidence on SMEs' contributions (as in Little *et al*, 1987). One important factor that contributed to such divergent views on SMEs strengths was the concept of enterprise size. Therefore, before considering the reason for and statistical claims on SMEs re-emergence, I first address the conceptual problems.

**First, the concept of an SME.** To begin with an SME, as a unit of analysis, combines two units: small and medium enterprises. In this sense an SME is a simple mental construct because at any particular time and context an enterprise can only be either small or medium but not both. Any conclusion on an SME is therefore susceptible to a bias to one particular size. Complicating this further, enterprise size definitions and subsequent interpretations widely vary within and between developed and developing countries (see Box 2.1)<sup>15</sup>. The very term SME was meant to minimise these variations in size definitions (Storey, 1994:13) but, as we will see below, this did not seem to have solved the problem.

In the context of LDCs, there were also some divergent views over the share of SMEs in the size structure of enterprises. Some (as in Peres and Stumpo, 2000:

---

<sup>14</sup> It is important to note that there was other official and research based literature that provoked further work on small enterprises in different countries. One of these was the Bolton Commission Report in UK (1971) that gave due emphasis to exploring constraints of small firms and areas of support needed to avoid losing them. The review in this section largely addresses the underlying strengths of SMEs. SMEs constraints and policy implications come in the subsequent sections.

<sup>15</sup> Definitions of key terms like an SME or any other important discussion that create some digression in the chapters are given in boxes.



1644) perceived that relative to large enterprises, SMEs had a higher share in the size structure of enterprises and hence contributed more to employment. Others (for example, Navaretti, 1994: 4) considered SMEs as the 'missing middle' in the size structure of enterprises. Neither of these views has universal validity. The actual share of SMEs in the size structure of enterprises vary between countries reflecting the circumstances of those countries, and the variations also depend on the way SMEs are defined.

### Box 2.1 Approaches to defining the size of an enterprise

Approaches to defining the size of an enterprise: what is an SME, and does it exist? Curran and Stanworth (1986) argued that people tend to have preconceived notions of size - small and/or large. The concept of size, therefore, includes (or is based on) the researcher's definition, or that of the enterprise's owners or employees - an approach referred to as 'grounded definitions' of size.

But widely applied SME definitions, as an approach, use qualitative and/or quantitative measures. Within largely quantitative approaches the two common roots to size definition of an enterprise are using economic and statistical criteria. The economic criterion refers, for example, to an enterprise's relative share of a market, independent existence and the role of the owner in management. Statistical definitions, in turn, refer to quantifiable variables such as employment and the size of capital invested. Most academics and institutions (such as Harper, 1984, Storey, 1994, and World Bank, 1994) prefer to use statistical measures based on employment. These groups argued that measures based on employment were inflation-proof, transparent, comparable and easily available. However, making adjustments for seasonal and part-time labour, family labour, and over-time labour remain practical problems.

Enterprise size, which is a dynamic concept, varies considerably between and within countries reflecting features of sectors of an economy, legal status and ownership structures of enterprises. In the USA an enterprise employing as many as 500 persons could be small (Siropolis, 1990: 8), but in Ethiopia (as discussed below) an enterprise employing 50 persons could be classified as large. The very concept of an SME was coined by the European Council, in part, to minimize such variations in size definitions (Storey, 1994: 13). However, enterprise size variations persist, making SMEs elusive units. Regardless of the measures used, however, a large number of researchers agree that there is no universally acceptable definition of a small enterprise/SME (Storey, 1994, Sengenberger *et al*, 1990, and Harper, 1984).

Instead the purpose of definition, and simplicity and clarity of criteria, are more important than the actual cut-off points.

**Defining the size of an Ethiopian enterprise:** as of 1998, in Ethiopia there was neither official nor uniform definition of enterprises in general and SMEs in particular. However, different agencies and individuals defined an enterprise following both qualitative and quantitative approaches and classified them as cottage/craft, micro, small, medium and large. For example, the Development Bank of Ethiopia defined small enterprises as those that start up with less than three million *birr* (Getachew, 1998). The Central Statistical Authority (CSA, 1997d) also defined:

- medium and large manufacturing enterprises as those engaging 10 or more persons and using power-driven machines. Small manufacturing enterprises were those engaging less than 10 persons and using power-driven machines.
- cottage/handicraft manufacturing enterprises (regardless of employment size) were those that mainly used non-power-driven machines.

CSA gave neither size definitions for non-manufacturing enterprises nor provided separate definitions for medium and large manufacturing enterprises.

Researchers/consultants too used different definitions. For example, for the purpose of supporting rural based small manufacturing enterprises, Cameron (1988) defined these units as those 100 km away from Addis Ababa, employing less than 50 persons and *birr* 10 000 fixed capital at start-up. Shiferaw (1994) and Axe (1994) have defined small, medium, SME and large enterprises as those units employing 6-15, 16-50, 6-50 and >50 persons, respectively. Among other reasons, this latter definition was meant to serve for all sectors of the economy and researchers have started using it to construct and analyse survey based data (as in Abdela, 1995). I, therefore, adopted the 6-50 employment based definition of SMEs plus a minimum of *birr* 250 thousand capital investment at start-up.

Second, the statistical claims on the re-emergence of SMEs. Statistics (see, for example, Sengenberger, Loveman and Piore, 1990) seemed to show that SMEs made some positive employment growth relative to large enterprises. But such statistical claims were superficial because a careful assessment of the employment contribution of SMEs needed to consider, among other things, (i) the fact that fast birth and death rates were (and are) common characteristics of small enterprises,



(ii) among the survivors only a few small enterprises grow in size and (iii) the decline in employment in large enterprises was small (Storey and Johnson (1987), Storey (1994) and McCormick *et al* (1997)). What this meant was that, taking birth, attrition and growth rates of SMEs and large enterprises, the net employment contribution of SMEs may actually have been modest.

Moreover, in the literature the employment measure and contribution of SMEs were given emphasis, casting doubts over the presence of other strengths of SMEs such as competition, innovation and export. For example, the evidence on innovation was mixed or did not place SMEs in a better position than large enterprises (OECD, 1993). There were also wider issues like earning levels and quality of jobs in the SME sector. Referring to small enterprises, Storey and Johnson (1987: 41) showed that as the new jobs created were reflections of recessions, many of these jobs were part-time and poorly paid. Overall, though, a careful reading of the literature suggests that the SME sector, especially in employment measures, did in fact make a comeback (albeit only moderately) since the early 1970s.

**Third, the reasons for the re-emergence of the SMEs sector.** Many have dwelt on the reasons for the re-emergence of the SME sector (see among others, Piore and Sabel, 1984, Sengenberger, Loveman and Piore, 1990, and Curran, 1999). Of these Piore and Sabel's (1984) *The Second Industrial Divide* has been most influential in terms of providing (a) the evidence on sustained growth of the small enterprise and craft sector of Italy and (b) theory, referred to as flexible specialisation, for the re-emergence of the small enterprise sector. According to the flexible specialisation thesis, two major forces favoured the comeback of SMEs. First, technical-organisational efficiency - such as the advent of affordable technology - have overcome the 'scale economy' constraint. This was also looked at within the context of the ability of small enterprises (as opposed to large ones) to withstand



economic turbulence (such as recession/instability of demand). Secondly, the role of social or political influence (captured by small enterprises through, for example, lobbying) favoured small enterprises (Piore and Sabel (1984) and Sengenberger, Loveman and Piore (1990: 5)).

However, the flexible specialisation thesis, although given much prominence, was not adequately able to conceptualise and explain the dynamics of SMEs development. Its notion of flexibility was limited to technology while the notion of flexibility, as discussed in Massey, Quintas and Wield (1992), included wide ranging practices like part-time and temporary work, generalist skills and contracting out. What is more, counter-evidence produced from Italian clusters (Paloscia, 1991, and Brusco, 1995 and other European clusters like Baden-Wurttemberg (Semlinger, 1995) seriously challenged the stability of the thesis itself. For example, Paloscia (1991) argued that in the late 1980s, contrary to the 1970s and early 1980s, the regions of Milan and Lombardy were no longer dominated by small enterprises.

James Curran (1999: 8-9), writing from UK experience, provides a comprehensive list of factors that contributed to the re-emergence of SMEs: the re-assertion of an enterprise culture, change in technology, economic restructuring and globalisation, income effect and new patterns of consumer behaviour, a rise in unemployment since 1979, increased out-sourcing and vertical disintegration of large enterprises, reduction in red tape and privatization.

Following the foregoing theories and evidence over the last ten plus years, research and public policy, therefore, picked up the themes of new jobs, distinctive niches, competition, innovation, flexibility and cooperation and became synonymous with SMEs development. These theories and evidence also led to a variety of ways of assisting SMEs including through networking, business link and finance. For example, owing to SMEs' generally acknowledged lean and

flexible structure, networking among these enterprises were considered to provide benefits like access to new markets, increased productivity and resources use (such as by avoiding duplications of functions among members of the network) (Mallidi *et al*, 1999, and Mezgar *et al*, 2000). Furthermore, as it will be shown below, because these theories and evidence focused on SMEs, they appealed to the circumstances of LDCs.

### 2.2.2 SME theories and practice and the LDCs

The two pieces of literature that were most identifiable with SMEs in LDCs and contributed to the burgeoning literature thereof were Schumacher's *small is beautiful* and the theory of clusters.

**First, small is beautiful:** in his book *small is beautiful* Schumacher (1973) passionately argued for small enterprise in the developing countries for fighting the 'inappropriate' large scale technology (of developed countries). In small enterprises, Schumacher sought creation of jobs at low capital investment, promoting reliance on indigenous resources, levelling out rural-urban income differences and environmental considerations<sup>16</sup>.

**Second, cluster or collective efficiency theory:** this is attributed to the work of Schmitz and colleagues at the Institute of Development Studies, Sussex, on LDC clusters (Schmitz 1992, 1995, 1997, and Schmitz and Nadvi, 1999). The cluster study found that (i) clusters, such as Sinos Valley in Brazil, Sialkot in Pakistan and Agra in India, existed outside the developed world. (ii) successful clusters were those that were demand driven and acted collectively. Schmitz argued that clustering of enterprises internalises local external economies, generating competitive advantages to members of the collective. These benefits of clusters, it

---

<sup>16</sup> With a view to proving this philosophy, an intermediate technology development group (ITDG) was set up. ITDG assists small scale producers by providing technical skills and technology appropriate to their needs with the ultimate objective of improving the quality of lives of these producers (ITDG, 2001).

was argued, provided prospects for economic development through small manufacturing enterprises in the LDCs.

The concept of SME clusters is related to the concept of SME networks referred to above. Both networks and clusters require enterprises to collaborate and share facilities (like warehouses and service centres). However, the cluster and networking concepts are different. SME clusters require much more geographic proximity and sectoral homogeneity of enterprises (see, for example, Schmitz , 1995). SME networks, however, are spatially and functionally flexible. These characteristics of networks mean that they require better infrastructure and information and communication technologies, factors that are scarce in most developing countries. Nonetheless there are examples of agency assistance to networks that tend to encourage innovation of processes and products as in some UNIDO assisted networks (Rogerson, 2001).

**Strengths of developing countries SMEs:** As many would argue the beauty of small enterprises does not ensure success. SMEs must have unique strengths to succeed and bring about socially desired changes. Then the question would be whether SMEs in LDCs, as in developed countries, possess strengths, say in employment generation, innovation and/or enhance the industrialisation process?

First, a view supported by many researchers suggests that SMEs in LDCs create considerable opportunities for employment, income distribution spatial development and industrialisation (see, among others, McCormick, 1993, Cortes *et al*, 1987). At the heart of this argument is that these units tend to be labour intensive and spatially and sectorally flexible (that is not constrained as much as large enterprises are by infrastructure and market conditions). Given that capital is expensive for developing countries, the argument follows, SMEs use more of the surplus labour of LDCs. The implication of this argument is that the same logic, at least with equal emphasis, cannot be made for large and micro



enterprises. The majority of micro enterprises would never grow to maturity or peak as they start by offering 'safe' products with a known and fairly certain market leading them to intense competition that limits profits and growth potentials (McCormick, 1993). Even when other circumstances like infrastructure permit, large enterprises require a huge investment at start up that only a few can afford<sup>17</sup>.

Second, SMEs are more likely to ensure local ownership and control (Kamalkhani, 1991 and Storey, 1982: 25) than large enterprises. In some countries (such as Kenya - McCormick, 1993) the majority of large enterprises tend to be owned by foreign subsidiary enterprises. Instead of being invested locally and creating linkages, the profits of foreign owned companies are often repatriated. Harper (1984) associates the benefits of small enterprises with LDCs to local economies. He notes that small enterprises serve as sources of employment for the local poor and women, and provide access to local products for the poor. He also argues that small enterprises provide more job satisfaction using less management, and more of the profits from small enterprises are reinvested in the local economy.

Third, the argument that generated wider debate but less consensus was the role of LDCs SMEs in innovation<sup>18</sup>. The argument that runs against SMEs being innovative was based on the view that savings enabling the introduction of new machines and/or allowing the undertaking of research and development activities were more likely to be generated in capital intensive (less wage payment) situations (Cortes *et al*, 1987: 8). But Cortes *et al* dismiss this view and refer to

---

<sup>17</sup> Again there is a need to be wary of enterprise size definitions. As Little *et al* (1987) study on India showed, labour intensity tended to be higher in the range 26-99 workforce than in the 10-19 (p. 125). Little *et al* (1987: 17), hence went on to conclude that 'very small establishments (fewer than 10 workers) are destined for extinction unless they become a protected species'.

<sup>18</sup> The debate here is not on SMEs in developing countries pioneering the development of new machines and products but whether these units adopt new machines and equipment.

those who undermine the innovative capacities of SMEs as 'distant observers' (Cortes *et al*, 1987: 8). Based on country studies Cortes *et al* advanced the view that SMEs adopt new technology often in a series of steps that include using secondhand technology, learning to repair it, and finally buying (importing) new machines. McCormick's argument (1993) supports this later view that SMEs have the potential to generate local technological learning and develop technical progress and industrialisation.

Finally, it needs to be noted that there are many more but dispersed and less substantiated arguments in favour of SMEs in LDCs. It is also important to highlight that SMEs are not always beautiful. These units sometimes operate in 'bad' working conditions and pay the workforce less (Cortes *et al*, (1987) and Bromley (1985)).

To summarise, the theories and evidence reviewed above give some hope for the development of SMEs in LDCs. SMEs potential and actual job creating strength is particularly strong in LDCs. Following such strengths of SMEs, therefore, policy makers and donors may need to take wide ranging initiatives to assist SMEs. However, the challenges are that making LDCs SMEs flexible and networked requires more assistance in information and communications technologies, physical infrastructure, business culture and skilled labour. Section 2.2.3 below further explores agencies and the soundness of rationales for SME promotion.

### 2.2.3 The rationales and agencies for promoting SME development

Who wants to promote SMEs, and why? Before seeking answers to these questions it is important to note two contradictory developments that occurred over the last two decades. First, 'government activism' in the economy steadily declined. This was for various reasons including the increased power/influence of financial markets and globalisation (Arestis and Sawyer (1998: 1) and factors referred to as 'government failure' (like excessive state control of the economy

leading to corruption, bribery and nepotism) (WDR, 1991: 131). These developments led to measures like privatisation and deregulation. The second, contrary to the first development, was the birth of a 'new industry' that was committed to promote and support enterprises (Bridge, *et al*, 1998).

Who are these promoters of private sector enterprise? Chataway (2000) identifies agents of private sector enterprise promotion that include the private sector itself, NGOs, the state, bilateral and multilateral donors. These blocks of agencies consisted of a plethora of organisations largely based in the developed countries (DCs). In the 1990s even agencies like the World Bank softened their stance on interventions and endorsed 'market-friendly' intervention (WDR, 1991). Sweeney (1997: 157) noted that in the 1990s there were too many enterprise promoting agencies producing confusing and ill-coordinated initiatives (at least 250 different types of policies and programmes to support SMEs and entrepreneurship throughout the EU). By the DCs standards the number of private sector promoters and the initiatives in LDCs are fewer, nonetheless enterprise (especially SMEs) development is at the forefront of the economic policies of many developing countries (Rogerson, 2001, and Peres and Stumpo, 2000).

To return to the question of why agencies would want to promote SMEs, promoting agencies themselves, academics and consultants (Loucks, 1988, Sengenberger *et al*, 1990, OECD, 1993, and Storey, 1994) provided a long list of reasons for intervention in SME development including: job creation, innovation, fostering entrepreneurship, competition, serving a niche market, promoting regional development and conserving the environment (as discussed in section 2.2.1). But do these strengths of SMEs necessarily require assistance, or in other words, which markets failed to justify intervention?

On the face of it reasons for promoting SMEs may be grouped under alleviating supply and demand side constraints to SMEs start-ups and growth. Most



recurring supply-side problems range from (small) enterprises' inability to influence government policy, to a list of 'gaps'. These gaps include: the lack of an analytical approach to problem solving, learning gaps (experience and knowledge), and resource gaps - most importantly finance. On the demand side, for example, Tendler and Amorim (1996) state that enterprises tend to fail to take up supply side support such as credit and training. Hence, Tendler and Amorim argue that demand side support (including purchases by government departments) to small enterprises is more effective than supply side support. Moreover, intervention instruments too may be grouped under hard and soft supports. 'Hard support' includes such measures as finance and premises, whereas 'soft support' deals with training, consultancy, marketing and other advice.

Going back to the key question of how sound were the reasons for intervention, Storey highlights the contradiction that committed 'free market' governments resort to active intervention in the small enterprise sector but also found 'very little' justification for doing so (Storey, 1994: 255). According to Storey (1994), who studied a range of enterprise support initiatives, there were only a few initiatives that were sound in terms of a 'market failure' argument. First, the comparative weakness of small enterprises, that was their 'relatively high cost of compliance with government regulations' (Storey, 1994: 256) has generated a valid justification for intervention. Second, the presence of the 'appropriability' problem in the high technology firms provided a reason for support because unless small enterprises were able to appropriate the fruits of their own inventions the desire to be innovative will fail and financiers will withdraw their backing. The other reasons for enterprise support that Storey looked at included promoting competition and strengthening production chains through subcontracting.

Most of the market failure arguments for promoting SMEs were, however, driven by the logic of welfare economics. The view of this thesis is that welfare economics should not be the only guide for supporting enterprises. As Hodgson argued 'the objectives of firms are culturally and institutionally specific' (Hodgson, 1996: 410). This meant that entrepreneurs have many strategies like seeking to maximize profit and creating jobs (for themselves and members of the community). In a given context, therefore, such objectives need to be considered.

Beyond 'market failure' arguments, there were also signs that private sector enterprise promotion in some LDCs has become a means of promoting the different agenda of the agencies involved in the business of assisting enterprises. For example, in his Tanzanian study Hewitt (1999) noted the existence of different motives for promoting the private sector - while the Tanzanian government agenda was to overcome economic crisis and secure donors' financial assistance, donors like the World Bank sought to promote transition from state to private sector.

Finally those in the business of assisting the operations of private enterprises need to consider the form that assistance should take. As we will see in the next section, the question of 'how to intervene' needs to address issues like: (i) identifying targets and levels of intervention (such as SMEs, large and/or rural enterprises, microenterprises, etc. at the national, regional and local level). (ii) developing principles of intervention such as involving targets in problem assessment and design of the support system/structure (Argyris, 1970). (iii) identifying instruments that enhance (or work directly on) the objectives/rationale for intervention.

To sum up, the foregoing discussion showed that agencies (notably governments) initiate enterprise support policies with a view to maximising SME strengths like job creation, innovation and promoting competition. Governments also step into



private enterprise development to alleviate some constraints to SME development like shortages of finance. Within the LDC context, SMEs were promoted for reasons that include creating jobs, income distribution, spatial development and industrialisation. The discussion also notes that although there were many enterprise support initiatives, some of these initiatives lacked coordination and a convincing rationales. Inadequate reasoning for an initiative, I will argue, is a serious problem as this suggests that a particular instrument(s) used to assist SMEs may not have addressed their problems and subsequently achieved the objectives of a programme.

Within the foregoing broader context of supporting SMEs, the following section looks at investment incentives, its concept, rationales and instruments. As I will demonstrate in the next section, from the outset it has to be noted that assisting enterprises through investment incentives stretches over several decades preceding the theory and evidence that explained the re-emergence of SMEs. Investment incentives were used to assist large (often manufacturing) enterprises. The foregoing literature review, however, supports that, first, assisting SMEs through investment incentives, traditionally reserved to large manufacturing enterprises, has become a reality<sup>19</sup>. And, second, the reviewed literature underpinned the thinking behind any intervention - that is addressed questions like who, why and how to assist SMEs.

---

<sup>19</sup> There are several examples in this direction both in developed and developing countries. In the UK, for example, in 1999 the Chancellor of the Exchequer introduced a scheme referred to as enterprise management incentives scheme (EMIS) to encourage successful managers to set up new enterprises by allowing them share options worth up to £100 000 free of income tax (*The Economist*, Nov. 6, 1999). In developing countries, including as this study on Ethiopia would show, out of appreciation of the role of SMEs governments assist and protect them from competition from large foreign enterprises through investment incentives schemes.



## 2.3 The meaning of and rationale for investment incentives

Being central to this thesis, this section focuses on the instrument of investment incentives as a means of promoting enterprise start-up and growth. The section proceeds with the role, meaning and sources or 'determinants' of investment (section 2.3.1). Secondly, the meaning and types of investment incentives are addressed in section 2.3.2. Here, what investment incentives are supposed to influence (the objects of investment incentives) will be discussed. Finally in section 2.3.3 the rationales for investment incentives are considered.

### 2.3.1 Role and causes of investment

The theory of economic growth places significant attention to investment<sup>20</sup>, and shows close correlations between growth in output (specially manufacturing output), income and export and investment (or capital accumulation) (Lewis, 1955, and Kaldor, 1978). The theory identifies technology embodied in new equipment and machines as the key determinant of growth (as these equipment and machines enable the production of more output per unit of input or the same level of output for less use of input). More capital accumulation, therefore, was meant to create economies of scale and accelerate growth.

The theory of economic growth had significant policy implications for LDCs. It suggested that LDCs had to invest a higher proportion of their national income on new techniques of production<sup>21</sup>. The theory also meant that LDCs that could not invest and create new techniques of production should import those techniques. Those countries that were limited by or lacked the necessary resources (like

---

<sup>20</sup> Investment by households, governments and NGOs matter to growth, development and poverty reduction. However, the focus of this section, following the conventional literature, is on investment by private enterprises.

<sup>21</sup> Such policy implications were most obvious from W. Arthur Lewis's conclusion. Based on historical data from developed countries, Lewis concluded that investing 10-12 per cent of national income achieved 3 to 4 per cent of growth in income (Lewis, 1955: 202). For LDCs this meant that an even higher proportion of their income had to be invested to bring about growth and bridge the gap between them and DCs.

engineers, R&D fund) for investment still had to import these technologies even when it required borrowing and/or aid money. The other vehicle for technology transfer was attracting foreign direct investment (FDI).

However, as was found later, sources and conditions for growth were much more complicated than acquiring production techniques (Arrow, 1974). For example, knowledge that was not embodied in the new technology, that is 'disembodied knowledge' and learning-by-doing, were found to have contributed in causing growth. Moreover, as the examples given in Anderson (1990) show, growth in agriculture was partly due to improved husbandry and in manufacturing was partly due to improvement in organisation and reduction in managerial inefficiencies. Further, the state of skill, education and health of the population of a country, its institutions and the available public works like roads and natural resource endowment also contributed to growth.

A far stronger area of literature also gave due emphasis to building technological capabilities as sources of sustained growth than a mere acquisition of technique of production. According to this later literature, technological capabilities are largely internal to the firm and include firm specific or private knowledge (tacit knowledge), skills and management that emerge from in-house learning, innovation, and organisation that enables not only the development of new products but also improve on existing processes (see, among others, Navaretti, 1994, Najmabadi and Lall, 1995, Forbes and Wield, 2000, and Chataway and Wield, 2000).

The foregoing brief review of the literature suggests a narrow and broad view of investment. The narrow view considers investment as capital formation - the acquisition or creation of physical assets to be used in production (as in Coen and Eisnes (1987: 980). The broader view of investment considers learning and creating

technological capabilities as a means of sustaining growth and development<sup>22</sup>. These narrow and broad views of investment correspond to two views on technology put forward by Rhodes and Wield (1994). The first is that technology is 'machine-centred' where technological activities are perceived in terms of 'the production or use of hardware and their software' (Rhodes and Wield, 1994: 86). And the second view considers technology 'as a body of knowledge, one which centres on the accumulated body of learned principles, procedures, skills [...] deployed in the pursuit of technological goals or tasks' (Rhodes and Wield, 1994: 88). Here note that the latter view takes into account what the narrow view undermines: knowledge emerging from production methods, work organisation and 'machineless technology'.

In terms of policy implications, the narrow view of investment prescribes 'transfer' of technology while the broader approach suggests creating and building technological capabilities. As argued in Rhodes and Wield (1994: 87), among the limitations of 'machine-centred' view of technology was its focus towards machine intensive production systems. This could cause adverse consequences in many developing countries as machine intensity not only is incompatible with their resource endowment and market, but also expensive to acquire and implement.

Many developing countries, including Ethiopia, took on board the narrow view of investment and pursued the policy of technology transfer. The consequence of this strategy for LDCs, as Mytelka (1992) showed, was to undermine indigenous technological capability development. Mytelka (1992), based on her study of Cote d'Ivoire, demonstrated that technologies imported by LDCs or 'transferred' via FDI produced products and services similar to that where the machines

---

<sup>22</sup> This thesis, following the purpose and definition of the Ethiopian investment incentives scheme, follows the narrower view of investment. The emerging broader view of investment, however, will be discussed in the conclusion of the thesis.



originated. This strategy, Mytelka (1992: 224) argued, missed the 'purpose' of industrialisation - that is learning the technology, its specification and design, process, making use of local resources, relevant to local environment and demand. Moreover, particularly with regards to FDI, there were adverse welfare implications too, for example, where investment returns have been repatriated (Reis, 2001) without being invested locally so that linkages are created. Overall, what this review suggests was that the simplistic view of investment has been challenged, and over time the literature moved on to making investment and growth meaningful to people by linking technology to employment, development and reduction of poverty (Sen, 1975, Smillie, 1991, Jalilian and Weiss, 2001).

So far I have discussed the role of investment in growth and development. But what causes investment itself? According to the conventional theory of investment, a range of factors 'determine' or cause investment. These factors include: growth in output and per capita income, level of interest rate and increase in bank credit, high expected rate of return on investment, increase in consumer demand, political stability and favourable terms of trade (Oshikoya, 1994, Driver and Moreton, 1992 and Galenson, 1984). As this study will demonstrate, non-conventional causes of investment may also include factors like licensing procedures for investment and access to resources like land and energy sources.

The direction of effect (positive or negative) that some of the causes of investment produce are not always clear. Similarly, whether growth causes investment or the vice versa are not always clear (Jalilian and Weiss, 2001). But general growth theories and empirical evidence, as stated already, suggest a positive correlation between output growth and per capita income growth and investment (Driver and Moreton, 1992 and Oshikoya, 1994.). This relationship is often based on a linear link between savings, savings mobilisation and investment - that is higher

output/per capita income is supposed to result in a higher level (in proportion to national income) of savings which in turn leads to a higher level of investment.

I will argue that the assumed linear relationships between savings and investment may not be always clear. In some developing countries in particular, high income levels may not necessarily ensure either a high level of savings or investment. High income levels may be wasted on cultural practices like high expenditure during holidays, weddings and funerals which reduce the available savings. Similarly, unless the banking and taxation systems are strong, savings may not be mobilised and converted into investment. The role of government spending on private investment also matters. As seen in former socialist countries, growth in per capita income did not affect private investment as private investment was limited by law.

### 2.3.2 Meaning and types of investment incentives

As the foregoing literature review showed, assisting developing countries (manufacturing) enterprises has its root in the theory of development economics. Following this theory many developing countries, and African countries after independence, have introduced investment incentives (Galeson, 1984). Without going into the details of historical developments of investment incentives<sup>23</sup> below I will explore the meaning and types of investment incentives.

**The meaning of investment incentives:** What are the factors (or objects) that investment incentives are supposed to influence? The answer to this question forms an integral part of the definition of investment incentives. The World Investment Report (WIR) defined investment incentives as 'government measures

---

<sup>23</sup> UNCTAD (1996) refers to the first argument for investment incentives as made by the welfare economist Pigue in 1920. However, although historical records are dispersed and difficult to synthesise, there are indications that investment incentives were in use in the early days of industrialisation. This is apparent from Adam Smith's 1776 writing, in which he opposed particular encouragements, duty drawbacks, bounties and restraints such as tariffs - on the ground that these distort the operations of the market (Smith, 1976: 450-451).

designed to influence the size, location or industry of an investment by affecting its relative cost or potential for profit, or by altering the risks attached to it' (UN/WIR, 1994: 290). In a similar vein, UNCTAD (1996) endorsed the definition of investment incentives as:

... any measurable economic advantage afforded to specific enterprises or categories of enterprise by (or at the direction of) a government, in order to encourage them to behave in a certain manner' (UNCTAD, 1996: 3).

Investment incentives are, therefore, targeted to influence enterprise behaviour with regards to the size, location and sector of an investment. Moreover, investment laws of individual countries (see, for example, OECD, 1979) showed that investment incentives target enterprise start-up itself by granting incentives to both indigenous and foreign enterprises. However, in practice the notion of incentives (and their consequences) being wholly 'measurable' is unrealistic (see chapter four).

**Types of investment incentives:** The literature identifies three types of investment incentives (UNCTAD, 1996, and OECD, 1979):

- **fiscal incentives:** tax based concessions, for example on investment, profit, value added, import of goods like machines, equipment and raw materials. The main instruments of fiscal incentives are duty and income tax exemptions. Levels of concessions are often expressed in terms of per cent and number of years (holidays). Fiscal incentives are commonly used by developing countries facing shortages of financial resources to support enterprises.
- **financial incentives:** these are direct grants and subsidies to enterprises. Grants for the purchase of machines and equipment, buildings; subsidised access to industrial sites, grants for labour and/or other operating costs, and training subsidies. Upper/lower limits to the size of financial incentives may be set as a per cent of investment capital, profit, etc. Developed countries, relative to developing countries, use more financial incentives for enterprises.



- other incentives: these include the provision of specific infrastructure, as in enterprise zones, and subsidising training, preferential access to foreign exchange, etc.

Fiscal incentives are, therefore, only one component of investment incentives. And there are key differences between fiscal and financial incentives. Among other things, the effects of fiscal incentives:

- are contingent upon or follow entrepreneurial action and result. This means that exemptions from import duties and income taxes depend on the actions of actual importing and making profits.
- unlike financial incentives no direct financial resources are required to grant incentives.
- are less flexible. Fiscal incentives do not provide immediate cash flows that may be employed in different ways.

From the nature of investment incentives it therefore follows that many factors affect enterprise and economy wide impacts of investment incentives. These factors include:

- the level and type of tax rates and tax accounting systems. This means that (a) whether a tax exemption is based on 5 or 50 per cent of value determines the level of incentives. (b) for income tax purposes, for example, small enterprises may not be readily available to tax authorities. In this case whether taxes are exempted or not matters very little. Import duties, on the other hand, are easy to administer at the point of entry. (c) whether tax accounts exist and tax collectors are incorruptible also matter.
- relative costs (or substitutability) of resources: relative costs of labour, capital and costs of raw materials influence the options for import and domestic acquisition of these resources. Interest and inflation rates also affect the use of borrowed money for investment and hence the use of incentives.
- the attractiveness of a particular sector and location for investment also matters. Political stability is also a factor for investment to take place and hence incentives to be used.

- time lag for policy to work. For example, in Ethiopia income tax incentives are granted on the assumption that enterprises will be set up and make profits within one to five years.
- associated services such as access to enterprise site and utilities also affect the use of incentives.

Why were the objects of investment incentives such as influencing the behaviour of enterprise with regards to the size, location and sector so important? And how sound were the reasons for investment incentives? With these questions in mind, below I consider the rationale for investment incentives.

### 2.3.3 The rationales for investment incentives

Studies (Galenson, 1984, and UNCTAD, 1996) present arguments for investment incentives within the context of foreign investment. I will argue that those arguments can legitimately be expanded to include indigenous enterprises/investment. Hence the rationale for investment incentives may include:

- (1) **the infant industry argument:** this is essentially an economic development argument to support a specific activity like engineering where there is a need for a long learning period and profitability of investment may well be in the long term. If private enterprises are reluctant to invest in such activities then there is a 'market failure' argument for granting investment incentives. In these cases investment incentives are believed to promote entrepreneurial, managerial and technological capability building. Incentive-induced imported technology promotes the transfer and diffusion of technology. As Wade argued, given that more external benefits are created relative to the social costs of supporting enterprises, then 'a prima facie case for intervention' is created (Wade, 1990: 13)<sup>24</sup>.

---

<sup>24</sup> Note that Wade's (1990: 12) argument was broader than simple accumulation of physical assets. This was apparent from his argument in assisting a firm that invests in acquiring and mastering technology (including involving 'reverse-engineering') through tax incentives for the potential loss of staff who leave the firm and get employed in a competing firm. Such assistance, Wade argued, reverse the possible underinvestment by firms as they envisage losing their potential benefits.



- (2) **the externality/spillover effect:** a related but not necessarily similar argument for investment incentives was the logic of economies of scale. It is believed that increase in the size of an enterprise in socially desirable sectors is associated with diffused knowledge and transferred technology that produce external benefits. From the benefits of scale economies and 'learning by doing' incentives result in declining cost, and declining cost makes enterprises competitive. However, it can be argued that this rationale has a downside - that is (a) technology transfer may well result in the introduction of 'inappropriate' technology and/or discourage the development of indigenous technological capabilities. And (b) support agencies are taken as best judges of the future/performance of an economy.
- (3) **the promotion of regional/sectoral linkages:** a similar rationale to the above is the strengthening of regional and sector linkages. Uneven distribution of resources, economic activities and income levels poses particular concerns for the health of a nation including in terms of political stability. An OECD document (1979: 13) strongly states that financial incentives are 'key instruments for regional policies'. Investment incentives strengthen regional (and sectoral) linkages and bring regional economies to the heart of development activities. The realisation of this, however, rests on the presence of factors like social and physical infrastructure. Secondly, substantial individual investments (that is with assistance) are also believed to generate sequential investment that creates spillover effects in selected areas and sectors.
- (4) **to compensate for lost return due to other distortions such as high interest rates/land costs.**

What level of incentives is sufficient to generate the desired effect? There are some general principles used in providing incentives to enterprises. First, incentives are provided if net social benefits are greater than private benefits. Hence, the difference between private and social benefits constitutes the level of incentives that will be granted to private enterprises (UNCTAD, 1996: 9). Second, investment incentives should make a noticeable impact on the performance of individual enterprises. However, I argue that in practice it is very difficult to



reckon the difference between private and social benefit and hence the 'real' amount of incentives to be granted.

As I stated at the beginning of this chapter, investment incentives are only a small part of broader factors that impact on enterprise start-up and growth. Hence with a view to putting the role and impact of IIS on enterprise start-up in context, below broader factors that influence the objects of investment incentives (that is enterprise start-up, entrepreneurial decisions on type, location and size of an enterprise) are studied. The section starts by outlining the enterprise start-up process and how investment incentives fit into the process.

## **2.4 Theories of SME start-ups and growth**

### **2.4.1 Enterprise start-up processes**

Enterprise (or business) 'start-up' study, according to Birley (1989) consists of processes that involve decisions to set up an enterprise and mobilise resources to begin operation. Enterprise start-up decisions, in turn, are influenced by complex factors. Gibb, for example, has identified four of these key factors: the motivation, commitment and ability of the founder, the idea (that is viability and acceptability in the market) and the physical and financial resources of the founder (Gibb, 1987b: 25).

Studies (among others, Gibb, 1987b and Fisher, 1988) have put key enterprise start-up factors in stages. For example, Fisher identified five stages of the process of enterprise start-up and stabilisation (Fisher, 1988: 90):

1. **idea generation.** Intention to start-up a business (production and/or service) and the motivating factors are the main elements at this stage.
2. **validation and conceptualisation of enterprise idea.** At this stage decisions are made on the type of product or sector that would be undertaken, and location of the enterprise.

3. **preparation on start-up.** Here feasibility of the project is tested in terms of its market potential and strategy, and finances, legal and organisation formats are decided.
4. **initial implementation.** At this stage premises and machines are purchased or rented, labour is contracted, etc. and the new enterprise is born.
5. **stabilisation.** This is an early stabilisation stage. The new enterprise either promises success or failure.

The purpose of investment incentives is to influence the choices of sector, location and size of an enterprise that refer to elements of stage two of the process of enterprise start-up. Investment incentives are also meant to influence enterprise idea generation (stage one). Moreover, through post start-up tax relief, they are meant to stabilise the growth of new enterprise start-ups.

Here entrepreneurs' cognition, that is their mental process of perception, memory, learning, problem solving and decision making (as, for example, in Daniels and Henry, 1998) is important. Entrepreneurs' decisions may rest on information from the environment or their own experience. But decisions in smaller enterprises may not be based on adequate or actively researched information. In this regard, Driver and Merton (1992) noted that many small firms are risk averse, largely because they have limited information and/or the perception that the cost of information may exceed the benefit of it<sup>25</sup>.

---

<sup>25</sup> In the same vein, a study by Gelderen *et al* (2001) showed a strong relationship between an entrepreneurs' ability to use information and his/her success. The authors identified four characteristics of strategies used by founders of small enterprises: reactive, opportunistic, complete planning and critical point strategy. The authors' definition of strategy included both that formally written down and loosely followed sketches in the mind of the entrepreneur. Based on 80 founders of small firms in the Netherlands, the authors found a positive and significant relationship between success (growth of enterprises, investment, profits, etc.) and the critical point strategy that founders followed. The reasons for this were apparent from the characteristics of the four strategies: those entrepreneurs that followed a reactive strategy were driven by situations, and made little proactive use of information. Those that adopted an opportunistic strategy, although proactive in terms of using information, deviated from their original course of action as opportunities arose. Complete planning strategy was not only expensive to carry out but also of less use as the uncertain environment changed. This left the critical point strategy as most successful as it focused on 'the main issue at stake' (Gelderen *et al*, 2001: 177).



The next sections discuss sources of enterprising ideas, and factors that influence the choice of product, location and size of an enterprise.<sup>26</sup>

#### 2.4.2 Sources of enterprising ideas

Before considering sources of enterprising ideas, here I start by clarifying the concept of the entrepreneur. Who is the entrepreneur? The extensive literature consulted (see, among others, Casson, 1987, and Binks and Vale, 1990) defines the entrepreneur in terms of his/her characteristics such as foresight, confidence, intelligence, perception and risk-taking. Gray (1998) who provides a comprehensive discussion on the typologies of entrepreneurs, shows how often entrepreneur characteristics (definitions) were two-way classifications: as craftsman vs. opportunistic and growth oriented vs. survivors. For example, Gray (*ibid*) explains that those entrepreneurs who were better educated, socially adept, actively seek and use information, and are the least driven by circumstances to start enterprises as growth oriented. Whereas survivors were situation driven (unemployment, redundancy, lack of alternative opportunity) and with only limited survival skills. According to Siropolis (1990: 42) 'survivors' include entrepreneurs that went into business for the 'wrong reason' such as being demoted, passed up for promotion, or fired. They had an uncertain outcome as far as success was concerned.

Some authors refer to entrepreneurs as people without wealth but having the insight to create businesses from scratch; others portray them as owners of businesses or owner-managers. In short, the literature does not provide a universally accepted definition of the entrepreneur. The view I have taken in this

---

<sup>26</sup> The relevance of contingency theory, or the 'law of situations' for the discussion in this section is acknowledged. The theory asserts that features of an enterprise are determined in such a way that the new enterprise fits into its environment (Carlisle, 1975). Enterprises, however, do not always fit into the environment they operate in. As the introduction chapter showed enterprises attempt to change their environment. For example, some of the cases studied here adopted technologies that were not labour saving, and some others changed the property right regime, etc.



thesis is that any SME founder or owner-manager is an entrepreneur. This founder does not necessarily start with a fundamentally 'new' idea. Given the presence of a demand/supply gap or inefficiency in the production of existing product/service, entrepreneurs react to these situations and set up an enterprise and become owners and/or managers. Based on entrepreneurs' motivations and performance a distinction, as in Gray (1998), will be made between those who are growth oriented and those that are survivors.

What are the sources of enterprising ideas? The reference point for enterprise ideas is the entrepreneur, the elusive agent of change (Schumpeter, 1961) or one with positive attributes of self-esteem obtained from parental encouragement (McClelland, 1961) or one whose entrepreneurial drives come from a troubled childhood and lack of security (Kets de Vries, 1985). Following economists' arguments (for example, Baumol, 1968, and Casson, 1987), demand for the entrepreneur is chiefly caused by individual profit opportunities or a return to entrepreneurial activities. And supply of the entrepreneur is determined by factors like mobility of people from non-entrepreneurial activities to entrepreneurial activities (or example, salaried managers and manual work to entrepreneurial work), entrepreneurial individuals from the indigenous population, net immigration, cultural attitudes and removal of barriers to entry.

The social-psychological approach to the study of entrepreneurs (or example, Cooper, 1986 and Stokes, 1998) looks into entrepreneurial traits, motives and backgrounds. Cooper (1986) puts the influence upon the decision to found an enterprise under the headings of:

- (i) the entrepreneur and antecedent influences upon the entrepreneur including family, religion and educational background, psychological make-up, age, earlier career experience, and opportunity to form entrepreneurial groups,
- (ii) the incubator organisation, the organisation for which the founder had worked before (geographic location, nature of skill and knowledge acquired,

motivation to stay with or leave the organisation, and experience in small business setting), and

- (iii) various external factors such as availability of knowledge about entrepreneurship, societal attitudes towards entrepreneurship, ability to save seed capital, accessibility and availability of venture capital, accessibility to customers, support services, opportunity for interim consulting and economic conditions.

Further, entrepreneurial attributes such as initiative, risk taking, independence or autonomy, need for achievement, control, leadership, and hard work (Gibb, 1987a: 6) may come from (a) pull factors like desire for independence, exploiting opportunities, work experience, financial incentives, and (b) push factors such as redundancy, unemployment and disagreement with previous employers.

Some SME studies make some broad generalisations some of which may not have any cross-country or temporal validity. For example, based on UK studies, Stokes' (1998) emphasis was placed on entrepreneurs' background including age, gender and ethnic origin as sources of entrepreneurship. The 35-50 and over 65 age groups were identified as the more likely entrepreneurs<sup>27</sup>. With reference to gender, women (as founders of enterprises) were said to be under-represented, and a married person has a better chance in succeeding in owning and running a small enterprise (Stokes, 1998: 35). With regard to social and class background, those who come from the lower middle class and those with a less academic background tended to run small enterprises. It was also suggested that minority ethnic groups in the West seemed to have better chances of setting-up small enterprises (because of inequality of job opportunities in the mainstream sector of the economy). This is again a woolly conclusion as not all ethnic groups produced an above average number of entrepreneurs. As Gray (1998: 48-49) argued, the

---

27 The assertion here is that while the 35-50 age group consists of those who wait until accumulating assets, the over 65 age group are those who go into business when their pension is inadequate to live on or they are forced to retire.



enterprising characteristics of some minority ethnic groups were more to do with social forces like family influences and an ability to network than being an ethnic group *per se*.

### 2.4.3 Causes of features of an enterprise

#### 2.4.3.1 Influences on what to produce

In the theory of firm (for example, Greer, 1992: 237) two factors are crucial for an enterprise to start offering a product or a service. These factors are motivation (to earn profit) and ability to make the attempt. Any factor that reduces the motive/ability of a potential entrant is referred to as barrier to entry (*ibid*, p. 237). These barriers (that also refer to growth and exit of enterprises) constitute a multitude of factors such as competition with established firms, mobility from one industry or location to the other, minimum economies of scale and sunk costs (that is the presence of relatively large investment that will not be recovered on exit).

Most elements of barriers to entry will be taken up in the discussion below. Here I specifically address founder decisions on product or service at enterprise start up. These depend on founders' understanding of the market: what buyers want (the quality/quantity of product/service) and the enterprises' ability to react to buyers' needs (in terms of business strategy these are referred to as key success factors - Grant, 1998. This also extends to the analysis of product/service close substitutes as buyers would be sensitive to price changes and switch to substitutes. The implications are that if the buyer is sensitive to price or quality then the new enterprise has to compete on price or quality.

It follows, therefore, that to develop a product/service that is commercially viable and establish a share in the market place the entrepreneur has to conduct market research on products/services supplied and consumed, size and type of enterprises. This is the prediction of theory of the firm, which in my view, does



not always reflect the reality in the SMEs sector in general and those in LDCs in particular. The theory of the firm also barely discusses entrepreneurial product/services choices at start up - its preoccupation on markets tends to be for established (often large) enterprises. Some founders of SMEs are known for not undertaking market research (but establish a single product and limited channels of distribution) (Bridge *et al*, 1998: 117).

According to the SMEs literature, however, the most important factor in determining the choice of a particular product/service is the founder. In this regard, Binks and Jennings concluded that in the small enterprise sector '... the decision as to what to produce is often made before the new entrepreneur has actually decided to set up his own business.' (Binks and Jennings, 1986: 7). This means that a product/sector known to the founder through experience, hobby, formal or informal training and family tradition provide a good part of explanations for taking up a new enterprise. Along similar lines, Fisher (1988: 92) argued that the choice of a product is 'highly predetermined by the work experience and history of the potential new firm founder'. However, although the extent of influence was not stated, some SMEs literature considers external inducement factors as having influence over the choice of a sector (or a particular product/service). Bridge *et al* (1998) listed many of these inducements including loan services, financial incentives and access to premises.

#### 2.4.3.2 Influences on where to produce

Entrepreneurs' location decisions - that is central or peripheral regions, and urban or rural sectors - depend on many things including differences in infrastructure, product and labour markets and levels of government support. For example, referring to Alfred Marshall's clusters, Krugman offers three explanations as to why and when manufacturing enterprises concentrate in one location. First, concentration offers firms the opportunity to pool industry-specific skills. Second,

localised industry supports production of non-tradable inputs. And third, information spillover enables firms to use better production functions (Krugman, 1995: 550-551). In other words, both demand and supply factors make manufacturing concentrate in a few sites. Demand for manufacturing output may come from agriculture, but a large part of the demand for manufacturing actually comes from manufacturing itself - hence the market gets larger where manufacturing concentrates (Krugman, 1995: 551).

Fotopoulos and Spencer (1999) who studied the spatial variation of the Greek manufacturing enterprises found that new firm formation was positively affected by public spending on infrastructure, regional specialisation and wealth and labour productivity of a region. The key policy implication that emerged from this study was that public investment in infrastructure building was crucial in spatial new firm start ups.

Oakey and Cooper (1995) discussed that agglomeration, as in Krugman (1995), may result in high cost of sites (especially in cities), and higher labour costs undermine the positive sides such as higher quality labour and services like banks. Similarly concentration of enterprises in specific locations may not be socially desirable most notably when spatial development issues, such as increasing incomes and differing activities between regions of a country, pose concerns for political stability and national security (Hamer, 1985: 3).

In enterprise location decisions, the founder's environment also has a key role to play. Cooper (1986: 109) argued that '[s]ince founders tend to start firms where they are already living and working, there must be organisations which will hire, bring into the area, and train the engineers, scientists, and technical managers who may someday become technical entrepreneurs'. Further, according to Cooper:



If an area is to develop and maintain technical entrepreneurship, organisations which can serve as incubators must be present, be attracted, or be created. (Cooper, 1986: 109).

Cooper referred to 'technical entrepreneurship' - that is those in the engineering firms - but his explanations on location factors and entrepreneurial attributes seem to be generally true.

The literature referred to also showed that non-economic factors also affect founders location decisions. Oakey and Cooper (1995: 348) highlighted that 'personality factors may be important when choosing a plant location, thus forcing a compromise between economic and psychological factors'. Based on the Brazilian experience, Hamer (1985: xii) argued that '[f]irms do, in fact, appear to ignore unfamiliar territory unless they belong to that minority committed to a major move.' Consequently, Hamer argued, '... it is not surprising that hypothetical or actual packages of municipal incentives do little to alter behaviour' (Hamer, 1985: xii).

To summarise, new enterprise formation is associated with public investment in infrastructure, market (both demand and supply side), entrepreneurial attributes including their social and psychological attachment to a particular location.

#### 2.4.3.3 Factors that influence enterprise size

Enterprise size is a feature of an SME study because, as the foregoing sections showed, the argument for SMEs is largely based on size. There is a substantial volume of literature on factors that determine enterprise size (including on small enterprises - see, among others, a survey by You (1995)).<sup>28</sup>

---

<sup>28</sup> You (1995) related determinants of small enterprise size to four strands of theories: microeconomics of minimum economies of scale, transaction cost theory, theories of industrial organisation and business life-cycle model. You (1995) discussed that, first, in the conventional microeconomics (also referred to as technological) approach, minimum economies of scale (and scope) determine size. The foundation of the minimum economies of scale is a fall in average unit costs owing to increases in the scale of output. Second, according to the institutional/transaction cost theory, using markets to make transactions



However, the literature on factors that determine enterprise size at start up (notably for SMEs), with the exception of limited recent contributions like Gorg *et al* (2000), is generally thin. Gorg *et al* (2000) nominated industry size and growth, minimum efficient scale (MES), and changes in the macro economic environment as explanations for enterprise size at start up. Based on their statistical analysis of the Irish firms, the authors found that large enterprises did not enter markets where MES was low (this was, on the one hand, to avoid competition but on the other hand in search of a larger market). Most interestingly, the authors also concluded that while generally industry size and growth determined start up size of large enterprises these factors did not influence the start up size of small enterprises.

Studying enterprise size at start up, I will argue, is more complicated than determining statistical relationships on selected variables. Several questions need to be asked and answered: what is the measure of size and why do enterprises across and within an industry choose different intensity of capital?

To begin with, as the discussion in Box 2.1 showed, there are several criteria (including employment, capital investment, sales and profits) that can be used to define an SMEs size. Leaving aside the post enterprise start up size measures like sales and profits, SME size defining criteria at start up can be narrowed down to factors employed (only to labour and capital invested). Since investment incentives focus on fixed investment (plants, machines and equipment)

---

involved such costs as search, contract, and means of discouraging opportunism. The extra transaction costs of organising production (which often rises with the size of a firm) was the limiting factor for the size of the firm (Coase, 1988). Third, industrial organization theories put forward explanations such as entry and exit barriers, monopolies, and competition as determinants of firm size. Fourth, the life-cycle model, which dealt with birth, growth, maturity and decline of firms was popular in the small firms literature (Stanworth and Curran, 1981, Gibb and Scott, 1986, and Storey, 1994). The life-cycle theory describes stages from business idea generation to business organisation, maturity and stability. I argue that the major weakness of the life-cycle model is that stages do not apply to all firms as some firms obviously start at a higher stage than others. Moreover, as discussed before, not all small enterprises grow to maturity or peak.

momentarily we can also limit the discussion on size to capital investment criterion. But what constitutes capital investment is another issue. If capital investment is only to MES of the technique employed (as the conventional firm theory would suggest)<sup>29</sup> then this will be very simplistic, and, as Lazonick (1991: 94) argued, intellectually inadequate. When a firm chooses a technique (high or low fixed cost) there is the invisible capacity - emerging from unique combinations with other inputs that result in different levels of output. This means that a particular technique of production does not produce one unique isoquant/output for every firm. Firm specific capabilities (such as organisation and skills) make up the difference.

A related issue is enterprise size at start up across and within an industry. According to Lazonick (1991: 95) 'business strategy' - that is choice of an industry and supplying a particular product and/or service - suggests a certain level of capital intensity in production and hence affects enterprise size. Also within an industry entrepreneurs choose different intensity level of machines. This, again, is very much related to entrepreneur related factors (resources, strategy, and the level of risk taken), and a question of factor substitution. Employment and capital measure of size do not always go together for the presence of factor substitution.

What the above discussion shows is that implicit assumptions of microeconomics and industrial organisation theories on enterprise size are rather simplistic. For these theories easy substitution of factors and perfect information about factor prices led them to the simplistic analysis of U shaped cost curves. As I will demonstrate in this thesis, not all entrepreneurs start business with perfect information nor do they install machinery that enables them to achieve a declining cost curve that easily. However, entrepreneurs may deploy a variety of strategies

---

<sup>29</sup> MES raises the question of how many plants and production-lines make up an enterprise. This again suggests that the definition of an SME includes its legal personality (that is the extent to which different units/plants are legally independent).



including using second hand or craft technology: they step-wise build upon fixed capital with a view to learning not only the technology but also the reliability of the market, and the quality of labour force operating the machines. At an initial stage of technology adoption, entrepreneurs may not even know of the existence of cost effective technology. Even when the existence of a particularly effective technology was known that technology may not be affordable, and when affordable it may not be chosen because of technical and demand limitations. More importantly, the choice of a technology itself would be influenced by other stronger factors such as experience, skill and financial resources of the founder(s). It is also important to state that the literature says little about other factors, in my view, that have significant influence on enterprise size at start up and the start up process itself. To give a few examples, first, it is not only the profit motive of 'business strategy' that determines enterprise size but also entrepreneurs' other motives like whether the entrepreneur wants to increase employment (say for relatives). Second, enterprise size depends not only on the productivity of labour and capital (as the theories tend to focus on) but also on institutions and physical infrastructures like energy and water sources, the financial market that provides credit to the entrepreneurs, macro-economic variables like wages, interest rates and exchange rate levels. Third, as this thesis will demonstrate, the role of the state (regulation of the number and size of enterprises, for example), availability of foreign exchange for the purchase of machinery and other inputs are also bound to affect enterprises (including start-up pace, size and location). State control on resources like enterprise site and utilities also impact on enterprise development. Finally, as section 2.4.4 below shows, the way business and government interact with each other also has considerable impact on enterprise development.

#### 2.4.4 Business interest groups and enterprise development



In chapter one I stated hypothesis two (H2) which suggested that the IIS licence and structure provided entrepreneurs with access to resources that were outside the IIS system. Does this hypothesis have any theoretical backing? Drawing on theories of public choice and institutional economics, this section briefly discusses an aspect of business and state interaction.

Institutions such as government agencies, political parties, economic organisations like enterprises and social organisations provide a range of (positive and/or negative) incentives that shape human interactions (North, 1990). For example, governments provide formal rules, laws and structures for contracts which, among other things, define property rights. In some societies these rules are inadequate and/or manipulated by agents like business interest groups, bureaucrats and politicians in practices commonly referred to as 'rent-seeking activities' (Udehn, 1996: 28). Bhagwati (1984) referred to these same practices, which in his view led to social wastage, as 'directly unproductive activities' (DUPs).

Rent-seeking behaviour/DUP is about interest groups (like business agents) attempting to influence policy in their favour. The common form of rent-seeking is lobbying for a privilege that provides a monopoly to supply goods and services, tariffs, quotas, protection from branches of industry, direct transfers in the form of subsidies and income (Dunleavy, 1991: 28). To get and maintain such privileges interest groups use multiple strategies including petitions, lobbying elected representatives, raising issues in the media, commissioning research, involvement in consultations, public campaigns, demonstrations, attempts to obstruct policy implementations, non-cooperation with government, boycotts or non-compliance, strikes/industrial action and civil disobedience (Dunleavy, 1991: 20).

Rent-seeking is said to be positively associated with corruption like paying bribes (Udehn, 1996: 28). But, as Self argued, interest groups and politicians work

reciprocally - a two way traffic: '... pressure groups cannot succeed unless they can also win the support of politicians. Public choice theorists stress the significance of an exchange relationship between politicians and interest groups for mutual advantage.' (Self, 1993: 31).

Rent-seeking behaviour is also said to be detrimental to an economy and society.

Some claimed that deadweight losses from rent-seeking behaviour, as a proportion of the national income lost, accounted for 7.5 and 15 per cent of the Indian and Turkish economies respectively in the 1970s (Colander, 1984: 9).

Colander also suggested solutions like providing information, adjusting property rights and changing institutions to curb rent-seeking behaviour. The extreme neoliberal solution is to prevent governments from intervening in the workings of an economy at all (Udehn, 1996: 29). These views on rent-seeking behaviour are, however, disputable. For example, Samuels and Mercurio (1984) looked at rent-seeking behaviour as an attempt to change existing property rights - a rejection of the status quo property relations. From whichever angle issues emerge, in this thesis I maintain the view that interest group and rent-seeking behaviour impact on enterprise start-up process and development.

To summarise, sections 2.3 and 2.4 above raised issues that are central to this thesis. From the synthesis of strands of theories it has emerged that:

First, the impact of investment incentives on enterprise development depends on several factors: entrepreneurs' awareness and perception of incentives and the size of benefits from incentives. Moreover, whether entrepreneurs respond to government objectives is crucial. Entrepreneurs' response to investment incentives, in turn, depends on the nature of the entrepreneurs themselves (like their resources and ability and willingness to move between locations and activity types), market, government regulations, institutional and physical infrastructure.

Second, the key enterprise features that the IIS is expected to influence are sector (product and/or service), location and size of an enterprise. These key features of an enterprise are closely related and mutually reinforcing. For example, an entrepreneur's choice of a sector influences the location of the enterprise or vice versa. Both sectoral and location decisions are also likely to influence enterprise size. Similarly the strategy of choosing a sector in part determines the size of investment in machines and equipment. As the previous discussions showed, the key determinant of the decisions on a sector, location and size of an SME is the entrepreneur. The entrepreneur (along with his/her attributes and resources), in turn, is strongly influenced by the broader social, psychological and economic forces. In considering IIS impact on enterprise size, therefore, these factors will be taken into account. It is within this context that the next section reviews the literature and presents the evidence on the impacts of investment incentives on SMEs start-up and growth.

## **2.5 Impacts of investment incentives on SMEs start-ups and growth**

As the earlier sections showed most countries, poor or rich, promote their enterprise sector including using investment incentives. The literature I studied showed many examples of countries that used investment incentives schemes including those from South East Asian countries (as in Wade, 1990). However, there were only a few studies that showed the performance of the investment incentives schemes in different countries. The review presented below, therefore, focuses on a limited number of studies published to show the effectiveness of investment incentives schemes. With a view to reflecting on the nature of enterprises and entrepreneurs and their operating environments (and subsequently the outcomes of the schemes) I have discussed separately the impacts of investment incentives in LDCs and DCs.



**Impacts of Investment Incentives in LDCs:** LDCs largely depend on fiscal incentives to encourage domestic and foreign enterprises to invest in their economies (UN/WIR, 1992, Galenson, 1984). Ghana was typical in using fiscal incentives that provided entrepreneurs with duty and income tax exemptions to promote enterprise development. Ingram and Pearson (1981) studied the impacts of investment incentives on enterprise start-ups in Ghana by looking at seven enterprises that benefited from the scheme in the 1970s. Ingram and Pearson (1981: 849) found that ‘... [the] policy set created positive private profits for five of the seven firms in spite of the fact that all but one were socially unprofitable.’ Since only one of the seven firms was socially profitable, the conclusion of the study was that the sample enterprises did not effectively promote government objectives but created ‘large social costs’ (Ingram and Pearson, 1981: 839).

Argentina used investment incentives to alter spatial patterns of industrial enterprises. But, according to an extensive study by Borello (1995), investment incentives in Argentina did not promote spatial development. Policy failure was, among other things, because entrepreneurs’ decisions failed to take account of information (example, production cost) in supported regions. Moreover, entrepreneurs had a ‘distorted and biased view of the interior of the country and insufficient information on promotion schemes and production costs’ (Borello, 1995: 587).

India supported its small industries since independence in 1947 through diverse incentive measures (like fiscal incentives, reservation of products for government purchase, concessional bank interest rates, etc.) (Subrahmanya, 1998). The overall impact of these support measures, however, was that small enterprises remained small because growth meant more licensing regulations, loss of guaranteed market, high financial and labour cost, etc. (Subrahmanya, 1998: 39).

A study made on Colombia (Cortes *et al*, 1987: 149) found that in Colombia, as in many LDCs, small and medium industry 'start-up has been essentially a result of entrepreneurial effort and resource mobilisation; neither the credit system nor government programs appear to have played a significant role'. Note that this later finding was an overall summary of all government support programmes without singling out the impacts of the investment incentives.

**Impacts of Investment Incentives in DCs:** Grant (1996) analysed the effect of US state-sponsored economic development policies (EDPs) on new enterprise formation. These EDPs included five supply side policies: (i) tax policies that reduce the tax burden imposed on corporations, (ii) debt financing programmes that make or guarantee loans to business, (iii) labour market deregulation policies that lower the cost associated with labour, (iv) geographically targeted policies meant to stimulate development in selected areas within states, and (v) regulatory policies designed to reduce the costs for corporations in complying with environmental standards (Grant, 1996: 35).

Using cross-sectional time series data (on all the EDPs but item five above), Grant's study showed that:

... only one of the four policy types - debt financing - significantly increased new business formation. (Grant, 1996: 40).

The implication of this finding, according to Grant, was that new enterprises favour 'states which provide financial assistance for fledging enterprises' (Grant, 1996: 40). Overall, Grant concluded that 'state-sponsored EDPs advocated by proponents of state entrepreneurship were found to have negligible effects.' (Grant, 1996: 41).

An Irish study (Lenihan, 1997) looked at the impact of grants on indigenous enterprises in terms of the concepts of additionality, deadweight and displacement (for clarification of concepts see Box 2.2). The finding of the study

was that the regional grant to enterprises resulted in 20 per cent of additional jobs (but up to 79.4 per cent deadweight) (Lenihan, 1997: 727).

**Box 2.2      Concepts and measurements of impact analysis of enterprises support: deadweight, displacement, additionality and viability**

Questioning the rationale for a particular support initiative to enterprises is perhaps where an enquiry starts. But the issues that follow include the notions of deadweight, displacement, additionality and viability. While viability of a supported enterprise or a scheme in the long term is perhaps easier to understand, understanding and measuring net additionality is more complicated. Additionality refers to the principles that, firstly, a scheme does not result in diversion of resources from other activities, and secondly, supported enterprises would not exist (on the same scale, location or time) without public support. Additionality is very much related to the concept of deadweight. It is not always the case that growth or start-up of an enterprise is determined (or even necessarily supported) by a particular support. Some enterprises successfully start up or grow without support. The concept of deadweight then applies to those entrepreneurs (enterprises) that take public support but who would have started up anyway (Gray, 1998, Lenihan, 1997, and Storey, 1994). In reckoning deadweight, measures like assisted enterprises that survived and created more jobs may be used.

In the light of the objectives of this thesis, first, the concept of deadweight is expanded to cover different levels and the degree to which entrepreneurs would have started business without assistance. Hence deadweight in this thesis considers the degree to which investment incentives influenced the timing, location, size and sectoral choice of the entrepreneurs. If IIS has influenced enterprise start up dates or locations and industries identified/chosen by the policy makers, or positively affected the size of the enterprise then it has created some degree of additionality (and there would be only partial deadweight with regards to the variables it failed to influence). However, if the IIS failed to influence any of these variables then there would be a total deadweight. Second, as subsequent chapters show, quantitative evidence on IIS that shows all levels of deadweight is difficult to generate. Hence whenever it is not possible to find direct evidence, an indirect measure of deadweight is used (for example, whether the IIS was factored into the decision to start up an enterprise at a particular time, location industry and size. This is used as an indicator of the presence or absence of deadweight.)

Finally the concept of displacement. This refers to support to some enterprises that could make them better able to compete and therefore possibly lead to the forcing out or displacement of existing enterprises. Similar to the concept of deadweight, displacement can be seen at different levels: due to the activities of the assisted enterprise another enterprise (often



a direct competitor to the assisted ones) may cease operation or part of the operations of the unassisted enterprise may be adversely affected. In the thesis incidences of this process will be considered. It has to be said, however, that the literature only emphasizes displacement (the negative side) without giving equal consideration to the possible positive multiplier effects due to the assisted enterprises such as an increase in number and/or size which could actually encourage new activities to emerge.

A study based on 100 UK enterprises that received industrial investment incentives found that for some enterprises incentives were an important influence to locate in assisted areas (Allen *et al*, 1986). Similarly, a comprehensive study made on some regions of European states showed that tax incentives (for enterprise start-up and expansion) were 'a necessary condition for an effective regional development strategy for SMEs (Giaoutzi *et al*, 1988: 12).

To sum up, the evidence from the countries studied above was inconclusive in suggesting that investment incentives were an effective means of promoting enterprise development. However, it was clear that investment incentives worked better in DCs than LDCs. This may be due to the fact that DCs offered direct financial grants to enterprises and/or the enterprises operated in an environment (including institutional and infrastructure) that was supportive to enterprise development.

On the basis of the evidence studied above, I argue that perhaps many other reasons made the performance of investment incentives different between and within DCs and LDCs. For example, firstly, the size and composition of the enterprises that receive investment incentives affect performance. This means that whether an enterprise is small, large or capital intensive may make a difference in the take-up and use of support. Second, the type and level of 'investment incentives' provided, such as the level of duty exemption, matter in terms of the take-up and performance of support. Third, a range of other country specific circumstances like availability and cost of credit (or enterprise site) affect the performance of investment incentives. Overall, the message that emerged from

these limited country studies was that investment incentives as a idea of promoting enterprise development was a contested one. Any generalisation about the effectiveness or otherwise of investment incentives was heavily subject to caveats. As I will reiterate below, this conclusion is central to my argument.

## 2.6 Conclusion

In this chapter the literature reviewed demonstrates, among other things, that a modest SME strength in job creation generates many enterprise support initiatives. Furthermore, the literature shows some trends/developments particularly relevant to policies towards the SMEs sector:

- that, in recent years, in spite of the decline in the active role of a government in the economy, governments, NGOs and donors 'market-friendly' intervention in the private enterprise sector (notably SMEs) has been steadily increasing.
- that the number of enterprise support initiatives proliferated but some of the initiatives were less coordinated, and lacked adequate rationales to merit the commitment of public resources.
- with a view to increasing support take-up and impact (also reducing cost) recent enterprise support initiatives have increasingly become demand driven - especially SMEs networks have become vehicles to provide information and enhancing the process of innovation.
- relative to the number of SME support initiatives there was only limited knowledge of the effectiveness of these initiatives.

Drawing from multiple discipline areas, the literature also shows sources of enterprising ideas, and factors that influence entrepreneurs' decisions on the type, location and size of an enterprise. The review found that entrepreneurship and entrepreneurial choices on the type and location of an enterprise were largely determined by resources and the socio-cultural background of the entrepreneur. Enterprise size, in turn, was influenced by the available technology,



entrepreneurial resources and strategy. In this regard investment incentives have had only a minimum role to play.

The discussion in this chapter also showed that investment incentives (which were diverse in content) were common instruments of enterprise promotion/development in DCs and LDCs. But there was only limited knowledge about the impact of these instruments on enterprise start-up and growth. The available limited evidence offered only ambiguous outcomes - with more likely positive outcomes occurring in DCs that had better infrastructure and offered grants in the form of financial incentives.

As this chapter demonstrated, the nature of entrepreneurs and enterprises, the size of benefits from investment incentives, institutional and social infrastructure crucially determine the effectiveness of an investment incentives scheme. Focusing on these issues the following chapter, therefore, discusses the background on the Ethiopian enterprise economy and the IIS.

The above conclusions are the theoretical basis of this thesis. At this juncture it is also important that the conclusions of this chapter are linked with the conclusions from section 1.2 in chapter one. As shown in section 1.2, when the IIS was introduced in Ethiopia in 1950 it was an innovation. Ethiopia pioneered in Africa in using the IIS to attract FDI and technology transfer, and build large scale manufacturing enterprises. In the early 1960s it also took the lead in Africa in using the IIS to assist its indigenous enterprises. However, when the IIS was reintroduced in the early 1990s the lessons from other countries on SME development (reviewed in this chapter) were not considered. Instead Ethiopia, once again, used supply driven IIS to support enterprises that were less likely to be assisted through the IIS. Against this background, and the hypotheses made in chapter one, the thesis set out to investigate the role and impacts of the IIS on enterprise start-up and growth in Ethiopia. What was the rationale for investment



incentives in Ethiopia? Was it an effective instrument to influence entrepreneurs' decisions over the choices of location and sector of their enterprises? This thesis seeks answers to these and many more questions.

### **3. The Ethiopian Enterprise Economy and the Evolution of the Investment Incentives Scheme**

#### **3.1 Introduction**

Chapter two discussed the literature on the foundations of promoting enterprises, particularly focusing on the rationale and impact of investment incentives on enterprise start-up and growth. The conclusions of chapter two showed that, among other things, enterprise and entrepreneur characteristics, infrastructure, type and size of investment incentives hugely contribute to the effectiveness of an investment incentives scheme. This chapter builds on chapter two in that, with a view to looking at IIS impacts, it thoroughly studies features of Ethiopian enterprises, entrepreneurs and investment incentives. The chapter addresses two major areas: first, the genesis and current state of the Ethiopian enterprise economy and, second, the evolution of the Ethiopian investment incentives scheme (IIS) and other non-IIS enterprise support institutions and services.

The discussion on these major areas serves different purposes. First, it sets out the background of the development and constraints on the Ethiopian enterprise economy and its support initiatives. By documenting these background developments in this chapter, subsequent chapters of the thesis will focus only on current issues of the research problem. Second, the discussion in this chapter also supports the research design issues (chapter four) and the conclusions of the thesis (chapter eight) which reflects on the breadth and depth of the enterprise support system of the country. Finally, the chapter also defines some concepts used in the thesis and clarifies the nature and extent of enterprise support initiatives available for the selected case.

In the rest of this chapter sections 3.2 and 3.3 review the evolution and current state of the Ethiopian enterprise economy. Section 3.4 discusses the genesis and current state of the IIS, and section 3.5 examines the non-IIS enterprise support

institutions and services. Finally section 3.6 provides the conclusion to the chapter and the links to the key hypotheses of the thesis.

The evidence on the past and recent state of the Ethiopian economy, the IIS and other policy initiatives comes from wide ranging sources. These include official policy documents on the IIS and the economic adjustment programme, conference proceedings, survey reports and statistical documents.

## **3.2 Background to the Ethiopian enterprise economy**

This section briefly discusses the origins of modern enterprises<sup>30</sup> in Ethiopia.

### **3.2.1 The earlier historical context**

Apart from the five years of the Italian occupation (1936-41), Ethiopia is the only Sub-Saharan African (SSA) country that never fell under foreign rule. Ethiopia is also the only SSA country to have developed its own written language. Ethiopia's recorded history goes back to at least the Aksumite Empire of the late B.C. and early AD (see among others, Bahiru, 1991, and Pankhurst 1961). The Aksumite empire had a prosperous trade-based economy that minted its own currency and built a civilization that still is alive. The empire was converted to Christianity in 370 AD and continued to thrive until the emergence of Islam in the seventh century. The rise of internal rebellion and the emergence and expansion of Islam, that resulted in the loss of trade routes, were among the reasons for the fall of Aksum. Aksum was replaced by a less prosperous Zagwe dynasty which later ended in 1270.

---

<sup>30</sup> Defining 'modern enterprises' in Ethiopia is a complicated matter. If an enterprise uses some machines, commercial energy and paid labour then I will refer it to as modern enterprise - that is not handicrafts nor subsistence agriculture. Similarly by 'enterprise economy' I refer to acts of producing (goods and services) and selling for gain by agents (private, government and cooperative) rather than to subsistence agriculture and craft sectors.



The period that followed the Zagwe dynasty was characterised by internal conflicts (as in the 'era of princes', where regional lords had more power than the monarchy), great internal migration (mainly of the Oromo people) and absence of a permanent capital. Regional unrest forced rulers to spend considerable time moving from one part of the country to another. It was with the founding of Gonder in 1636 that the country once again found a permanent capital.

In pre-Gonder Ethiopia craftsmanship was a common production practice of households, churches and monasteries, and courts of the emperors. With the emergence of Gonder the demand and supply factors for the development of handicrafts arose. But until the late 19th century a modern enterprise economy neither grew out of handicrafts nor was introduced to Ethiopia through the import of foreign technology.

### 3.2.2 The modern Ethiopian enterprise economy

#### 3.2.2.1 The beginning

The origin of modern enterprise in Ethiopia was related to a combination of factors that include the introduction of foreign technology, the development of modern infrastructure and education and the emergence of urban centres. The construction of the Franco-Ethiopian railway (1897-1915), the introduction of telecommunications and postal services in 1899 and the construction of roads like Addis Ababa-Alem and Dire Dawa-Harar were among the key markers of modern enterprise development in Ethiopia. After centuries of bartering Ethiopian money started to be printed in 1894 and the Bank of Abyssinia was opened in 1905. The set up of the first non-religious school, Minilek II, followed in 1908, and then hospitals, hotels, etc. were set up in Addis Ababa at about the same time (Bekure, 1980).

With regards to the set up of processing establishments, owing to its importance to national security, earlier governments established firearms factories as in Gafat

in 1860s and Ankober in 1874. Then the first printing factory was opened in 1897. Food processing factories like flour and oil mills were set up in the early 20th century, particularly in towns that emerged along the Ethio-Djibouti railway.

The pace of modern enterprise building was hampered by the Italian occupation of Ethiopia (1936-41). During the occupation period, the Italians built over 6000 km of roads (Eshetu, 1995) and initiated numbers of small enterprises but only a few of the projects were completed and 'suited to the needs of the Ethiopians' (Korten, 1972: 31). According to Bekure (1980) only 4 factories that served Italian soldiers were opened. This slow progress in enterprise building during the occupation may have been attributed to the fact that Italy had only a short spell in Ethiopia. But it can also be argued that Italy never wanted peripheral Ethiopia for anything more than a source of raw materials. In a nutshell, the occupation period produced long term adverse consequences for the development of modern Ethiopia. One example of this was that the Italian invasion resulted in the execution of three-quarters of educated Ethiopians (Korten, 1972: 28) that contributed to the subsequent slow pace of enterprise development in the country.

Apart from some piecemeal developments in modern enterprises, the structure of the economy (output, employment and use of technology) barely changed in the period before 1941. However, post 1941 three contrasting phases of enterprise development (mainly manufacturing) followed. Following, among others, Eshetu (1995) I will briefly account below for the major developments that took place (i) during the period 1941-74 where a genuine industrialisation process can be said to have taken place. (ii) 1974-91 where Derg reorganised enterprise development along socialist lines. And (iii) the post-1991 features of enterprise development.

### 3.2.2.2 The period 1941-74

According to Ethiopian economic historians (see details in Shiferaw Bekele, 1995) the industrialisation process of Ethiopia started in earnest in the post Italian



occupation. Two major signifiers of the post 1941 developments were (a) the introduction of incentives and facilities with a view to attracting foreign capital and (b) the introduction and implementation of three successive five year development plans (1957-74). In response to increased demand for consumer goods in urban centres, especially by the ruling class and royal family, and a shortage of foreign exchange for importing those goods, the manufacturing sector was promoted with a bias for import substitution strategy. The private sector was encouraged by putting protective tariffs up and provision of special investment incentives (IGE, 1968: 218).

In terms of achievements the development plans produced some positive but below target results. In 1950 there were 126 manufacturing establishments mostly located in Addis Ababa. These manufacturing establishments had a salaried workforce of 10,000 (Shiferaw Jammo, 1995: 22). Over the period 1953-61 the net value index of manufacturing increased by 2.5 times and manufacturing employment increased by 40 per cent (Eshetu, 1995: 205). Between 1963 and 1974, 54 more manufacturing plants were established (Sileshi, 1988: 260). Most of the enterprises were owned by members of the royal family, the ruling class and foreign nationals (mainly Italians, Greeks, Armenians and Indians) residing in Ethiopia (Sileshi, 1988: 260).

The structure of manufacturing was dominated by food and textile industries that were dependent on imported raw materials. There were barely any heavy and metallurgic industries. Concerning the non-manufacturing activities, agricultural technology too remained backward. In 1960 Ethiopia had only around 1000 tractors, and an insignificant amount of fertilizer consumption. Services (including distributive trade and transport) rose from 10 per cent of GDP in 1950 to 23 per cent in 1969, and 34 per cent in 1974 (Shiferaw Jammo, 1995). Overall industry was not in any position to play the role of 'the engine of growth'. Over-reliance on



foreign investment and technology, archaic feudal institutions (especially in providing access to land), reliance on import substitution strategy, a poor engineering base in manufacturing and an inadequate supply of power and infrastructure were some of the factors accounting for the low performance of the three five year development plans (Shiferaw Jammo, 1995). Some of these same factors contributed to the eruption of the 1974 revolution.

### 3.2.2.3 The period 1974-91

Political and economic crises prompted the overthrow of the Imperial Government of Ethiopia in 1974. Two of these crises were, first, the monarchy failing to extend power outside its own circle and being unable to control discontent particularly among the intelligentsia and the military. Secondly, being the key means of livelihood for most Ethiopians, pervasive ownership of rural and urban land by members of the royal family, the church, few landlords and absentee landlords caused landlessness and poverty (see details in Clapham, 1988).

With a view to releasing resources for socialist economic development the military government (the Derg) introduced several radical changes including nationalisation of land and main undertakings like industries, radio and television transmissions, insurance and banking. As a consequence, however, the emerging capitalist class, as Befekadu (1994: 36) noted, became 'diminutive' and joined the informal sector. What was more, some of the better trained people (including doctors and engineers) and entrepreneurs left the country.

Meantime the Derg continued new institution building such as rural and urban grassroots organisations (known as *kebeles*), leading the economy through the central planning and resettlement programmes. Successive national plans envisaged increasingly greater shares for the state and cooperative sectors. During the Derg time handicrafts and small scale industries accounted for only 5 per cent

of total industrial output, and were allowed to operate on a cooperative basis both to increase productivity and to prevent the comeback of a capitalist class (Clapham, 1988: 149-50).

After 17 years of experiment results were disappointing. Land reform failed to enlarge the size of peasant cultivation and hence land fragmentation and agricultural technology remained unchanged. Consequently, agricultural output and the livelihood of the peasant did not improve (Desalegn, 1985). Moreover, with the exception of the Derg's initiatives in setting up a few state farms (Itana, 1994) and 10 heavy industries (Sileshi, 1988) the economy remained predominantly subsistence (agriculture) and vulnerable to the vagaries of nature. Even among the few state owned enterprises (224 of them) nearly half were loss making year in year out (Kuma, 1994). According to Kuma, price control, lack of competition and over staffing were some of the reasons for the poor performance of public enterprises. Overall, during the Derg era, for over a decade the economy grew at a negative rate or less than the growth in population. Civil war and drought also contributed to the bad performance of the economy (see details in Eshetu and Mekonen (1992) and Befekadu and Berhanu (2000)).

Here I emphasise the strong implication of Derg's policy for enterprise development. Because it was stifled as a matter of policy, the state and cooperative sectors either limited or crowded out the activities of the private sector. There were strict licensing procedures for the private sector such as applying capital ceilings for running undertakings. Credit and foreign exchange were also geared towards the state and cooperative sectors. Entrepreneurial spirit was undermined and people were more attracted to politics, civil services and the army than setting up their own enterprises (particularly in the productive sectors). The economic environment was not hospitable for FDI to operate in Ethiopia either. During this period it was the informal sector and illegal trade that thrived.

### 3.2.2.4 Post 1991 developments

The Transitional Government of Ethiopia (TGE) (1991-95) underwent yet another round of change in the system of government. First, the new government embraced the free market economy and abandoned socialism and central planning. This policy paved the way for, among other things, the introduction of an economic reform programme of stabilisation and liberalisation. Second, on the grounds that the capitalist sector was weak, TGE made a commitment to intervene in the economy. Third, with a view to solving internal conflicts, rivalry and regional imbalances, power was decentralized to regional governments (see, for example, EPRDF, 1994). These changes were introduced with the support of multilateral creditors and donors and a section of the population at home. The new government got this support on the grounds that it accepted democratic principles including free elections.

Hence in 1992, the TGE launched comprehensive reform measures which specifically consisted of stabilisation of prices, budget and current account deficits, price and trade liberalization, encouragement of the private sector, privatisation, and other reforms in the fiscal and the civil service systems (see, for example, TGE/IMF/WB, 1993). The IIS became a key economic and political instrument of intervention in the economy and aimed to address regional imbalances (Proc. No. 15, 1992; TGE, 1992).

Besides the economic reform programme, the government pursued a development strategy referred to as Agriculture Development-led Industrialisation (ADLI) (EPRDF, 1994). ADLI, as a long term strategy, was adopted to redress the failures of export led growth and import substitution industrialisation strategies (Tegegnwork, 1995). The strategy aimed to raise the productivity of smallholder agriculture, labour intensive and domestic raw material using industries and bringing small scale industries into centre stage. The strategy primarily focused on agricultural development in order to increase the



domestic market for industrial development. According to this strategy, development proceeds with small farm development through improved practices, then rural infrastructure building, and at stage three development of commercial farms follows. The ultimate goal of ADLI was to transform the economy in favour of industry.

Two major limitations to the strategy were identified by researchers (Befekadu and Berhanu, 2000: 197). First, the strategy failed to address the major weakness of Ethiopian agriculture that was low labour productivity. Second, the institutional framework put in place for accessing land has become a constraint to the success of the strategy. This means that an increase in commercial farming was hampered because of the constitutional arrangement that prohibits private ownership of land.

Over the period 1992-98 the economy grew by 4.4 per cent per year. Savings and investment also recovered. For example, gross capital formation recovered from 10 per cent of GDP before the reform to an average of 15 per cent of GDP during the reform period (Befekadu and Berhanu, 2000). There were different interpretations of the sources/causes of growth. Government sources (as discussed in Tambek, 1996: 2) and *The Economist* (March 13, 1993) suggested that 'good policy' has contributed towards high growth in the economy. However, the critics were sceptical of the statistics saying that the year-on-year growth was due to low factor base. For example, in 1993/94 the economy attained the level it was in 1989/90 (*Addis Tribune*, 23 August 1996). They also note that growth in agriculture in particular was due to favourable weather conditions. But whatever explanation was accepted it would be difficult to dismiss the contributions of weather and 'good policy' to growth. In short, developments in the 1990s too had several implications for enterprise development. The introduction of an enabling environment and the IIS were key positive developments.

The discussion above showed that the growth of the Ethiopian economy in general and the enterprise sector in particular were stunted for a long time. The causes of such slow pace enterprise development were not simply economic in nature nor the consequences of the policies of a single era. Below, owing to space limitations, I will briefly state some of the broader causes of underdevelopment of the Ethiopian enterprise sector. These include:

First, as economists have always emphasized, inadequate savings, investment and incentives, inappropriate use of technology and the excessive role of the state in the economy have contributed to the slow pace of enterprise development (Sileshi, 1988, Eshetu and Mekonen, 1992). Further, drought and environmental degradation, war and civil unrest, turbulent political transition and inadequate democracy, centralisation of power and unfavourable external relations like terms of trade and debt have been the other causes of underdevelopment of the sector. Backward technology and poor infrastructure (including roads, energy, marketing arrangements and irrigation agriculture) again contributed to slow pace enterprise development (Shiferaw Jammo, 1995: 54).

Second, part of Ethiopia's culture has been adversely impacting on development. For example, high profile of warriors and/or fighting, the support of a win-lose attitude, opposition to change, an authoritarian environment for children's upbringing, women being limited to domestic work, inward-looking attitudes and rigid habits (of food and drink) have been hindering the broader social and economic development (Habtamu, 1995, and EEA, 1997b).

Third, religion and feudalism too were adversely impacting on entrepreneurship and enterprise development. The explanation for lack of entrepreneurship in Ethiopia that Ayalew (1995) discussed was the constraining 'dominant value' that was encapsulated by the feudal system and the Ethiopian Orthodox Church. For centuries, the feudal system resisted change and despised enterprising people and

activities, notably crafts and commerce. Common superstition has always been held against the artisans and merchants (for example taking them as devils or subjecting them to low status). The church puts its attention on 'life after death' and the worthlessness of worldly life.

Moreover, although Ethiopia has been proud of its written language, education has never played an essential role in development either as an input to development or as an element of change to undesirable cultural practices. This was primarily because until the early twentieth century Ethiopia's educational tradition was built around religious institutions (monasteries and mosques) with the primary objective of serving religion. Such religious education was not related to practical skills like pottery and weaving. The clergy who were relatively unconcerned with the mortal world were only instrumental in transmitting such practices as the observance of religious holidays and lengthy fasting times (Teklehaimanot, 2000). Major internally or externally induced technological changes, for example, were considered as threats to religion and tradition. Pankhurst (1968: 722) cited examples of opposition to changes that were spearheaded by members of the church: that new technology such as Sahla Sellassie's 19th century grinding mill was condemned by the priests as the work of the devil and the cinema house and the bicycle were, respectively, referred to as 'house of Satan' and 'horse of Satan'.

Finally, Ethiopia's long and cherished independence also caused its isolation, resulting in marginal contribution of external knowledge and technology to its development. As historians showed (for example, Bahiru, 1991) being a landlocked country during Italian occupation of Eritrea (1890-1941) - and perhaps since Eritrea's independence from Ethiopia in 1993 too - had been a constraint in terms forging trade and other relationships with the rest of the world.



Section 3.3 below expands the discussion on enterprise development in Ethiopia particularly looking at features like structures of and linkages between enterprises in the 1990s.

### 3.3 Key features of the present Ethiopian enterprise economy

#### 3.3.1 The social, political and economic state of Ethiopia

Statistics on the Ethiopian economy are depressing. Recent major social and economic indicators of the country, in relative and absolute terms, were either bad or seemed to be deteriorating. As Table 3.1 shows, by the end of the 20th century infant mortality, life expectancy and illiteracy rates were the worst in the world.

**Table 3.1** Some social and economic indicators of Ethiopia

Indicator	Ethiopia	Sub-Saharan Africa	Low-income countries
population:			
- in millions (mid 1998)	61.3	628	3515
- annual growth rate % (1992-98)	2.8	2.6	1.7
GNP per capita (US\$, 1998)	100	480	520
life exp. at birth (years, 1998)	43	51	63
illiteracy (% of pop. age 15+)	65	42	32
infant mortality/1000 live birth (1998)	155	87	58
urban pop. (% of total, 1998)	17	33	31
production Structure (% of GDP)			
- agriculture	51.2	55.5	49.8
- industry	10.6	6.7	6.7
- services	38.1	37.8	43.5

Source: World Bank (1999) and Befekadu and Berhanu (2000).

In 1998 Ethiopia had 61.1 million people, making it the second most populous country in Sub-Saharan Africa (SSA). But Ethiopia's population grew faster than the averages of SSA and low income countries, depressing the already low level of GNP per capita (US\$ 100). Looking at the prospects for the Ethiopian economy

was even more frustrating. Ethiopian economists (Befekadu and Berhanu, 2000) estimated that 55 and 58 years are required for Ethiopia to reach the SSA and low income countries averages<sup>31</sup>.

The enterprise sector of Ethiopia was small, in the early 1990s the private enterprise sector accounted for only 13 per cent of the GDP (Borin *et al*, 1994: 1). This meant that Ethiopia's economy was predominantly subsistence agriculture and in 1998 more than 4 out of 5 people lived in rural areas. Some dated and some recent statistics showed that Ethiopia's physical infrastructure like roads and telephone lines were also too low. For example, by the end of 1980s Ethiopia had only 24.5 km road per 1000km<sup>2</sup> area (ONCCP, 1989). Similarly, according to WDR in 1997 Ethiopia had three telephone lines per 1000 population (WDR, 1999/2000).

### 3.3.2 Structures, linkages and constraints of Ethiopian enterprises

This section explores the current state of the Ethiopian enterprise system. The discussion here recognises that, first, enterprises are born into existing opportunities and constraints. Hence such factors like enterprise size, ownership type and/or forward and backward linkages affect the long term performance of an enterprise and impacts of policies like the IIS. Second, the output, employment, regional distribution, etc. contributions of new enterprise start ups (be it due to the IIS or not) are only understood within the context of existing structures. And, third, to the extent that it encourages the import and use of foreign technology the IIS may actually disturb the existing linkages between enterprises, for example, in terms of using local resources.

---

<sup>31</sup> Based on the assumption that Ethiopia, SSA and low income countries' economies on the average grow at 7, 4 and 4 per cent, respectively.

### 3.3.2.1 Size and ownership structures of enterprises

**The size structure of enterprises:** the private sector in Ethiopia was almost supplanted by the public sector between 1974-91. However, in the 1990s the sector was on track for fast recovery and growth. Recent statistics showed that (Table 3.2) about two million people in Ethiopia were earning their living in 1.1 million enterprises listed under the categories of manufacturing (small, medium, and large), distributive trades (DTEs), and cottage and craft enterprises (CCEs). Most of the jobs were created in the CCEs and DTEs. However, a relatively higher proportion of wealth, in terms of per capita value added, was created in the medium and large manufacturing enterprises (MLMEs) and DTEs. Small scale manufacturing enterprises (SSMEs) were the poorest performers in terms of manufacturing value added.

**Table 3.2** Some features of enterprises (as of 1996)

Enterprise category	No. of establishments	Persons engaged	Gross Value of production (mil. <i>birr</i> )	Value added per person ( <i>birr</i> )
MLMEs	642	91199	5799	20527
SSMEs	2731	8929	188	699
DTEs	212670	548483	4674	38465
CCEs	892719	1311745	2043	7007
Total	1108762	1960356	12704	6480

*Sources: CSA (1997b, 1997c, 1997d and 1997e) and own calculation.*

All sizes of manufacturing enterprises tended to concentrate in Addis Ababa and Oromia regions. For example, according to CSA data for 1996/97, overall 68 per cent of medium and large manufacturing enterprises were located in Addis Ababa and 48, 21, and 13 per cent of all manufacturing enterprises were, respectively, located in the Addis Ababa, Oromia and Amhara regions.



Following CSA definitions (see Box 2.1 in chapter two) the dynamics of the number and ownership patterns of enterprises have changed in the 1990s. The number of medium and large manufacturing enterprises (that employed 10 or more people) in 1992, 1994 and 1996, respectively, were 263, 499 and 642. Of these enterprises privately owned medium and large manufacturing enterprises were 131 (42.1 per cent), 330 (66 per cent) and 473 (73.7 per cent). Privatization of public enterprises and new business start-ups accounted for the increase in private enterprises. The food subsector accounted for 40 per cent of the 2731 privately owned small scale manufacturing enterprises (SSMEs). Similarly 40 per cent of the total SSMEs were located in Addis Ababa. Of the total cottage and craft industries (CCEs) 572011 (or 64 per cent) were rural based. In 1996 there were 212670 distributive and trade service establishments (DTEs) which employed 548500 people. In terms of spatial distribution, DTEs tended to be evenly distributed all over the country.

Private enterprises were also emerging in agriculture (cash crops such as tea, coffee, and sesame), transport and construction sectors. But there were no reliable data on the number and distribution of most of these activities. In the banking sector, however, five private banks with 39 branches had been set up by 1997. Among the branches 21 were in Addis Ababa and the share of private banks in the total banking services was less than 5 per cent (Yonas, 1999).

There was also a large number of economic activities performed by the informal sector that included household type establishments or activities which were neither registered businesses nor had operating licences. The informal sector activities generally tended to be small in scale and low in the level of organisation. Productivity and income were also low. However, the sector had always been an important job provider. For example, in 1996 the informal sector provided employment to 7330969 people. These activities have had little access to the

organised input and product markets like credit, technology and public utilities, nor did they get government support in the form of incentives (CSA 1997a).

**Ownership structure of enterprises:** sole proprietorship and partnership were the dominant forms of ownership structures (Table 3.3). Share and private limited companies were rare in the country but have had representations in the MLMEs and DTEs. In spite of the recent privatisation drive, public enterprises were still represented in the DTE and MLMEs subsectors<sup>32</sup>.

**Table 3.3 Enterprise/establishment numbers and ownership types (1996/97)**

Ownership type	Wholesale	Retail	Services	MLMEs	SSMEs	CCEs
Sole proprietor	7096	118861	78023	323	2622	881377
Partnership	421	3197	1165	40	71	10588
Share Company	29	56	4	12	4	-
Private Limited C.	169	148	848	70	9	-
Cooperatives	-	201	17	18	16	738
Public Enterprises	65	455	512	169	-	-
Others	-	813	491	10	9	16
Total	7780	123731	81060	642	2731	892719

*Sources: CSA (1997b, 1997c, 1997d and 1997e).*

Data on characteristics of Ethiopian entrepreneurs were patchy partly due to the highly aggregated nature of CSA data. Based on these limited data, some features of entrepreneurs are reported below.

### 3.3.2.2 Some characteristics of Ethiopian entrepreneurs

Data generated on Ethiopian entrepreneurs (Table 3.4) showed that women were less educated than men and fewer women owned and managed enterprises. For example, in the small scale manufacturing enterprises (SSMEs) sector the total literacy rate for the entrepreneurs was 89 per cent, but in this total women's

---

<sup>32</sup> Note that the category 'others' refers to ownership such as joint ventures.

literacy rate was only about 17 per cent. Similarly, for ownership and management of enterprises, men accounted for 74 per cent in the SSME sector. There were, however, exceptions at sub-sectoral levels. For example, in the manufacturing of food subsector (where women make traditional food like *injera*) women accounted for 52 per cent of the total ownership and management of enterprises. These data could be interpreted in terms of potentials. For example, as opportunities (like education) are provided opportunities for women entrepreneurs in the market increase.

**Table 3.4** Some characteristics of Ethiopian entrepreneurs (1994-96/97)

Characteristics of owners/managers	number	per cent
1. sex profiles:		
(a) Small Scale Manufacturing Enterprises	2913	100
Male	2158	74
Female	755	26
(b) Medium to Large scale Manufacturing Enterprise (sole proprietors only): total	320	100
Male	267	83
Female	53	17
2. literacy rates:		
Small Scale Manufacturing Enterprises (total)	2913	89.3
Male	2118	72.7
Female	795	16.6
3. other characteristics of SMEs (total)	85	100
(a) pre enterprise start up occupation		
- trade		35
- similar to the new enterprise		29
- other		36
(b) motivations:		
- need for diversification		34
- need for independence		40
- creating own employment		14
- other		12
(c) entrepreneurial types:		
craft		51
opportunistic		49

Sources: CSA (1997b), CSA (1997e), and Borin, et al (1994).



Borin *et al*'s survey (1994) also showed that 35 per cent of the entrepreneurs came from the trade sectors or had been operating in a similar business as the new business (29 per cent). Regarding motives for setting up enterprises, entrepreneurs were motivated by the desire to be independent (40 per cent) and the need for diversifying their businesses (34 per cent). The Borin *et al* survey (1994) labeled 51 and 49 per cent of Ethiopian entrepreneurs as 'craft' and 'opportunistic' entrepreneurs.

### 3.3.2.3 Linkages between enterprises

There are mutually beneficial relationships between and within sectors of an economy. The classic example is the relationship between agriculture and industry where agriculture makes labour, raw materials, market and capital contribution through taxation and/or through foreign exchange earning from agricultural commodities. Industry also supplies capital and consumer goods to agriculture. Linkages could also be between subsectors (food vs. engineering) or between sizes (small vs. large enterprises) of a particular sector. For example, there are forward and backward linkages<sup>33</sup> or supplier and buyer relationships. Such linkages help promote technology transfer, create more jobs and value added and possibly make use of more domestic resources. Consequently, the existence of linkages help save foreign exchange and build domestic capacity or self-reliance. In spite of these potential benefits summaries of research conducted by Mekonen Ayalew in 1995 and 1997 showed that:

- (i) linkages between subsectors, and small and large scale manufacturing of Ethiopia were weak. Between 1984-96 the backward and forward linkages between small-scale industries and large-scale industries were about 30 and 13 percent. This meant that 70 per cent of demand for capital goods,

---

<sup>33</sup> A forward relationship is about inputs, like semi processed inputs as in ginned cotton or leather, taken as a raw material by a producer further up the line of production. Backward linkage is the opposite where finished products like implements and spare parts are used by an enterprise as an input.

chemicals, spare parts, etc. by small-scale industries were met through imports. Similarly 87 per cent of raw and semi-processed inputs of large-scale industries were either internally produced or imported (Mekonen Ayalew, 1995).

- (ii) in spite of claimed benefits like access to inputs, technical advice and guaranteed markets, linkages between agriculture and industry in general were weak. Linkages between agriculture and agro-industry subsectors like food and beverages too were found to be weak. This was generally because agricultural incomes were too low to purchase modern industrial implements, chemicals and other inputs. Second, those chemicals and machinery (fertilisers and tractors) were imported which meant that there was either limited or no domestic production. Third, inadequate infrastructure for transporting agricultural and industrial inputs and outputs also limits the possibilities for forging linkages between sectors (Mekonen Ayalew, 1997).

There are other forms of relationships between enterprises that might be considered. These relationships include subcontracting, joint ventures, franchising and export trading companies. In Ethiopia there seemed to be limited joint ventures and sub contractual arrangements in the agro-industry sector. Dejene (1994) reported on contract farming arrangements made between farmers and Wonji Shewa Sugar Estate. However, in Ethiopia records on business practices like franchising were unheard of. A weak level of linkages was largely due to limitations in the legal processes (as most business relationships in Ethiopia were informal), standards and quality of products, an under-developed system of information and transportation, a limited number of indigenous enterprises, etc. (Borin *et al*, 1994). The implication of all this was that the opportunity for business developments through, for example franchising and subcontracting, was limited.

Below I will consider broader enterprise development opportunities and constraints.

### 3.3.2.4 Enterprise development opportunities, needs and constraints

The prospect for enterprise development in Ethiopia was not all grim. There was some encouraging potential for enterprise development including a huge supply of low wage labour, land and land based resources. According to EIA documents (1997a), agriculture, horticulture and agro-industries were potentially profitable sectors. There were also proven reserves of metals like gold and platinum.

Cultural heritage and archaeological sites were attractive to the development of the tourism sector. Domestic demand for consumer goods was also high. In recent years there were signs of improvement in the export sector too. The traditional export commodities of Ethiopia (coffee and skins and hides) were now expanding to tea, cut roses and organic sesame. In manufacturing emerging non-traditional exports included tractors, trailers and television sets assembled in Ethiopia.

According to the *Financial Times* (June 22, 2000), a recent African Competitiveness Report (that measured the direction and extent of change between 1996 and 1999) showed an improvement in Ethiopia's overall competitiveness index.

Accordingly, Ethiopia ranked 17 out of 22 countries in 1998, and 11 out of 23 countries in 1999. The improved political climate for business was said to be the major factor for the change.

However, all was not well. Recent CSA survey documents showed some enterprise start-up and growth problems (Table 3.5). The nature of the problems varied between and within subsectors. The top start-up and growth problems were identified as lack/shortages of capital, raw materials and premises and obstructions from government regulations. The survey documents also showed that medium to large manufacturing enterprises faced huge capacity utilisation problems. Out of 208 enterprises that responded to the survey questionnaire 26, 65



and 12 per cent, respectively, had shortages of raw materials, absence of demand for products and frequent breakdown of machinery<sup>34</sup>.

**Table 3.5 Major enterprise start-up and growth problems by enterprise groups (1996/97)**

Start up Constraints	total number	per cent
Small Scale Manufacturing Enterprises	2731	100
- lack of sufficient initial capital	975	36
- lack of supply of raw materials	420	15
- lack of working capital	324	12
- obstacles from govt. rules and regulations	185	7
Distributive Trade Enterprises	212673	100
- lack of sufficient own capital	89483	42
- lack of premises	32124	15
- government regulations	13065	6
Cottage and Craft Enterprises	892755	100
- lack of sufficient capital	429688	48.1
- inadequate skills	101397	11.4
- lack of supply of raw materials	58884	6.6
Major growth problems		
Small Scale Manufacturing Enterprises	1304	100
- demand constraints	246	19
- shortages of raw materials	173	13
- lack of working capital	99	10
Medium-large Manufacturing Enterprises:	618	100
- absence of market	214	35
- shortages of raw materials	117	19
- lack of working capital	34	6

*Sources: CSA (1997b, 1997c, 1997d and 1997e).*

A large survey on distributive trade enterprises used questions which specifically asked for the type of public assistance that entrepreneurs would like to receive. Out of a total of 212668 respondents the top four support areas which received more than 10 percentage points were: access to bank loans (38 per cent), access to

---

<sup>34</sup> From the survey report on MLMs it was not clear whether entrepreneurs were asked and responded to politically sensitive questions like access to land.

land (16 per cent), access to premises (16 per cent) and better government regulations (11 per cent).

To summarise, the discussion in section 3.3 above (and that in section 3.2) showed that the growth of the Ethiopian economy in general and the enterprise sector in particular were low. From the discussion it emerged that causes of Ethiopia's continuous decline into poverty were due to consequences of governments policies and factors deeply built in the culture, religion and history of Ethiopia.

The next two sections review Ethiopia's enterprise development institutions and instruments used to support enterprises. Building on the discussion in section 1.2 in chapter one (see also Table 1.1) section 3.4. discusses the IIS, and accounts for the evolution and performance of the scheme. Section 3.5 will discuss the non-IIS enterprise support initiatives focusing on those covering a wider section of the enterprise sector.

### **3.4 The evolution of the Investment Incentives Scheme and its institutions**

As discussed in chapter one (section 1.2) the introduction of the IIS in Ethiopia in 1950 was an innovation. Consistent with the economic doctrine at the time, the scheme aimed to attract FDI and technology transfer. As the discussion in this section will show, since the 1950s the IIS has been changing in objectives and also to a degree in content. However, while the changes were evolutionary, the national and global contexts in which these changes have taken place were dramatically different. In fact to some extent the reintroduction of the IIS in the early 1990s can be seen as a move backwards to the 1950s context. The section also reviews the overall changes and continuity in the assumptions of the IIS and the provisions given to enterprises under the support scheme. The review mainly focuses on, first, the objectives, the nature of incentives and institutions of the IIS. Second, an assessment of impacts of the IIS over 1950-74. And, third, the rationales for sustaining the IIS for over fifty years.



### 3.4.1 The IIS policy and impacts (1950-74)

**IIS objectives and types and levels of enterprise support:** Section 3.2.2 above showed that in 1950 Ethiopia there were barely any modern enterprises to speak of. Consequently, the first investment incentives (see the definition in Box 3.1) policy was enacted to encourage foreign capital investment in Ethiopia (IGE, 1950). The key objective of the investment code was promoting manufacturing by offering new enterprises exemptions from the payment of (i) customs duties on imported machinery into Ethiopia and (ii) profit tax for five years from the date of commencement. Another decree passed in 1956 (IGE, 1956) expanded the areas eligible for five years of income tax exemptions to enterprise start up in the transport and mining sectors. However, the latter policy set a minimum investment of *birr* 200,000 to qualify for IIS support.

#### Box 3.1 The definition of investment incentives in Ethiopia

The Ethiopian investment codes (for example, TGE, 1992, and FDRE, 1996a) defined investment as expenditure of capital on machines, equipment, buildings, etc. with a view to establishing a new enterprise or expanding/upgrading the capacity of an existing enterprise. The investment codes aimed to influence the size, location and sector of existing enterprises as well as to encourage new enterprise creation.

The two major instruments that made up the Ethiopian investment incentives codes were: exemptions from the payment of duties on imported capital goods and the payment of income tax. Income tax exemption (1992-98) was for up to a period of three years in Addis Ababa and five years in some peripheral areas from the date of commencement of an enterprise. In the context of the discussion in chapter two (section 2.3), these investment incentives were essentially 'fiscal incentives'. However, the investment codes of Ethiopia has always used the broader definition - that is 'investment incentives' and hence in this thesis I also used 'investment incentives' instead of fiscal incentives.

Although the IIS policy of the 1950s was about attracting FDI it had some limitations from the start. First, the scheme was exclusively for non-Ethiopians. The consequence of this was that emerging and/or expanding indigenous



enterprises were excluded from the benefits of the scheme. Secondly, the scheme was not attached to particular policy objectives like addressing regional income inequality and/or increasing employment. Third, and most importantly, the scheme did not have institutional mechanisms for its promotion and implementation.

The 1950 investment policy was considerably revised in 1963 (IGE, 1963) and 1966 (IGE, 1966). Following the 1966 revision, IIS incentives were provided to private foreign and domestic enterprises (however, the authorities did not consider the fact that encouraging indigenous SMEs development might require different policies). Second, by way of institution building, an investment committee (with a permanent office and staff in the Ministry of Commerce and Industry) was created. The new committee was in charge of promoting and implementing the policies of the scheme. Furthermore, the revised law showed that (i) the scope of activities encouraged were widened to cover agriculture, industry, mining, transport and tourism areas. (ii) the categories supported included both new and expanding enterprises. But the type and level of investment incentives were, as before, five years of income tax and import duty relief.

**Evaluating IIS impact (1950-74):** In the literature limited references were made about the outcomes of the investment incentives schemes. The data used to evaluate IIS achievements were patchy, contradictory and dubious. The methodology used to evaluate the IIS was also flawed. With these notes in mind the evidence below was from the available limited literature on IIS outcomes.

Shiferaw Jammo (1995: 2) indicated that investment increased from *birr* 68 million to *birr* 128 million between 1960 and 1965. But the author did not show the evidence that the increase in investment was actually due to the IIS. Duri (1974: 295) concluded that agricultural activities did not respond to the IIS support because the complex land tenure system that lacked, for example, clear land titles

and inadequate access to fertile but peripheral areas of the country, were the problems. Mulatu (1982: 75) found that Ethiopian manufacturing enterprises were capital intensive due to a foreign technology bias, built into the investment policies of the imperial time.

Schwarz *et al* concluded that:

... in a number of large investments, extensive privileges were sought, granted, and fully utilized. In many cases the incentives granted were necessary for the investment to take place. (Schwarz, 1968: 91).

However, the Schwarz *et al* study was methodologically flawed. Firstly, neither growth in specific sectors nor increased inflow of foreign investment directly measure the performance of the incentives scheme as the authors thought. Sectors of the economy may have grown as a result of increased use of existing capacity. Moreover, growth in the economy and foreign investment may in fact have been due to the provision of better infrastructure like roads and power supply that were concurrently put in place. Owing to these confounding factors, therefore, I dispute the conclusion that the IIS had exerted an impact on the start-up of new enterprises.

Secondly, Schwarz *et al*'s study focused on macro level impacts of foreign investment in manufacturing, hence the main concern of this present study (impacts of the IIS on indigenous projects including non-manufacturing sectors), was barely considered. The study also failed to question the rationale for IIS enterprise start up support in the first place. It follows that from the Schwarz *et al* study it cannot be concluded that all the then new enterprises necessarily required support.

### 3.4.2 The IIS policy during 1990-98

#### 3.4.2.1 The IIS during the Derg era (1990-91)

As discussed before the IIS was discontinued between 1974-1990. However, a badly performing economy, civil war, drought and international isolation compelled the Derg regime (1974-91) to change its policy of excessive state control of the economy by the end of the 1980s. Derg's reform measures came under the rubric of mixed economic policy, the key part of which was the reintroduction of the IIS in 1990. The objectives of the 1990 investment code (PDRE, 1990) included: promoting economic and social development, increased use of domestic resources, introducing science, technology and know-how, generating employment opportunities, generating and saving foreign exchange earnings and promoting balanced inter-regional development.

Moreover, through the same decree, a large number of activities were opened for both joint and individual undertakings in the areas of agriculture, agro-industry, manufacturing and hotels. But activities like postal and communications services, air, rail and large scale shipping transport, and radio and television broadcasting services were reserved for the state.

The types of investment incentives were, as before, exemptions from payments of customs duties and income taxes. However, Decree No. 17/1990 (PDRE, 1990) had made a major break with the preceding IIS policies in that it added regional and size dimensions of activities into the support system. As Table 3.6 shows, the level of income tax relief (in number of years) took into account the size of new start-up and expansion investment projects in agriculture, industry and hotel sectors<sup>35</sup>.

---

<sup>35</sup> Because of its centrality for this enquiry, details of location and sector specific IIS support in this and subsequent periods are presented in Tables 3.6 and 3.7.



**Table 3.6** Location and activity based income tax privileges in years (1990)

Incentives by sector and size (in '000 birr)	New Enterprises	Expanding Enterprises	
	standard provision	provisions in preferred location	provisions for expanding enterprises
Agriculture:			
- less than 300	-	2	-
- 300 - 750	2	3	1
- 750 - 2000	3	4	2
2000 and above	5	6	3
Industry:			
- 50 - 500	-	2	-
- 500 - 1000	2	3	1
- 1000 - 5000	3	4	2
5000 and above	5	6	3
Hotels (> birr 300)	-	2	-

Source: PDRE, 1990.

In Table 3.6 IIS 'standard provision' and 'provisions in preferred location', respectively, referred to IIS support to locations not particularly chosen and those chosen (like peripheral locations) by the authorities. In preferred locations IIS support was for a longer period and included more small activities in the scheme. For example, an enterprise starting up with an investment capital of *birr* 2 million or more was meant to receive five years of income tax exemption under the 'standard provision' scenario. However, if the enterprise was set up in a 'preferred location' then the tax exemption period was increased to six years. Activities like hotels, however, always received limited support in the form of both duties and income tax exemptions.

Decree No 17/1990 (PDRE, 1990) also provided an institution for the administration of investment. Accordingly, an independent investment committee with a permanent office and staff was created. This time, however, there were

many sectoral committees for the administration of investment each granting licences for investment incentives.

Once more with the fall of the Derg in 1991 the IIS policy was discontinued. Evidence that I referred to suggested that over 1990-91 a total of 86 applications were made for IIS support and of these 75 were approved by the Investment Office of Ethiopia (Tsegaye, 1992: 360). However, whether these projects were subsequently implemented was not clear. The IIS impact of this period was, therefore, difficult to evaluate largely because of the short period available for the policy to have worked.

#### 3.4.2.2 Post 1991 developments of the IIS

The Transitional Government of Ethiopia (1991-95) reintroduced the IIS in 1992 (TGE, 1992). Subsequently, the same policy has been published as a law twice (FDRE, 1996a and FDRE, 1998b). All three major IIS laws of the current government have almost similar objectives of creating more jobs, increasing domestic and foreign private investment and promoting integrated and balanced regional development.

Although the latest series of IIS laws had similar objectives to that of the Derg policy in 1990, there were differences. First, the new codes were enacted under better enabling macro economic policy framework and Ethiopia restored better relations with the rest of the world. Second, in the new series of investment codes the scope of activities that were entitled for incentives were increased (to include insurance and banking activities, telecommunications, energy, health and education sectors).

Third, recent IIS laws systematically provide more incentives to domestic entrepreneurs and protection to smaller enterprises from competition from foreign companies. This was done in two ways: first, by raising the minimum entry requirement for foreign capital to US\$500,000 compared to only *birr* 250,000



(approximately US\$ 35700) for domestic entrepreneurs. And second, by creating a reserve schedule for domestic entrepreneurs alone. Furthermore, with a view to encouraging expatriate Ethiopians to do business in Ethiopia the definition of 'domestic investor' has also been broadened to include '... a foreign national, Ethiopian by birth, and desiring to be considered as a domestic investor' (FDRE, 1998b).

There was no change to the types of investment incentives, hence these remained exemptions from paying customs duties and income taxes. However, there were some changes in the details of the new code. First, exemptions from customs duties were extended to almost all capital goods. And, second, exemptions from income taxes were made on a more discretionary basis. To this end Reg. No. 7/1996 (COM, 1996) has introduced the concepts of 'pioneer' and 'promoted' activities that receive differential support based on the location of the activity. Here what made the new IIS laws different to those enacted in 1990 was that more focus was given to regional balancing of economic activities and sectoral integration.

Table 3.7 shows the number of years that enterprises were exempted from paying income taxes as provided in the investment codes of 1992 and 1996. Note that for the purpose of implementing the IIS the country was divided into three area categories: the Addis Ababa and Addis Ababa-Nazareth corridor, less developed areas and intermediate or other locations<sup>36</sup>. There were also two statuses of enterprises - new and expanding. For example, focusing on new enterprises only, Table 3.7 shows that, first, in the 1992 entrepreneurs who set up enterprises in the supported activities within Addis Ababa and Addis Ababa-Nazareth corridor

---

<sup>36</sup> A map of Ethiopia that shows these areas is given at the beginning of the thesis (page vii ). In the subsequent discussions, and whenever required, readers are reminded to refer to the IIS package given in Table 3.7 and the corresponding area map.



were entitled up to 3 years exemption from paying income taxes. Again in 1992, entrepreneurs in the intermediate and relatively less developed areas received three to five years more IIS support (that is in addition to those in Addis Ababa would have received).

**Table 3.7      1992 and 1996 income tax provisions (in years) by enterprise status and location**

<b>enterprise by status /location</b>	<b>IIS provision, 1992</b>	<b>1996 pioneer activities</b>	<b>1996 promoted activities</b>
<b>1. AA and AA - Nazareth Corridor</b>			
- new	3	3	1
- expanding	2	2	1
<b>Less Developed Areas</b>			
- new	8	5	3
- expanding	6	2	1
<b>Other Locations</b>			
- new	6	4	2
- expanding	4	2	1

*Source: COM (1996) and COM (1993)*

Second, in 1996 the category of 'supported activities' was differentiated as 'pioneer' activities (activities that the government targeted the most of its incentives) and 'promoted' activities. However, in terms of number of years, in 1996 exemptions from paying income taxes declined to a maximum of five years. But 'pioneer' activities and less developed areas were less affected by the change. Hence, in Addis Ababa, in 1996 the same privilege of incentives (as in 1992) was maintained to 'pioneer' activities while 'promoted' activities received only one year income tax incentives. Similarly, note that more preference was given to 'pioneer' than 'promoted' activities in locations further away from Addis Ababa.

By way of institutional development, first, a national authority (Ethiopian Investment Authority) and regional investment offices were set up to propose policies and oversee the activities of the IIS. Second, streamlined procedures for receiving and processing applications for IIS licences (for a fee of no more than *birr* 200) were created. A one-stop-shop (OSS) was also introduced in 1996 to provide services like operating licences for businesses and work permits for employing expatriates.

#### 3.4.2.3 Defining the nature and scope of the thesis: IIS role and impact (1992-98)

In this section I consider the most recent literature on IIS impact and then summarise the core IIS parameters that are relevant for the study period of the thesis (1992-98).

Since the IIS was reintroduced in 1992 studies made on Ethiopian enterprises have barely considered the link between investment incentives and enterprise start-ups and growth. The few studies recently made (for example, Admit and Getachew (1996) and Solomon (1996)) largely focused on description of the reform packages and considered (based on patchy macro data) the likely outcome of intended investment on employment and spatial development. These studies did not empirically investigate the response of entrepreneurs and enterprises to investment incentives.

One major exception, however, was a study made by Gavian and Gemechu who looked at the impact of investment incentives on commercial farms (Gavian and Gemechu, 1994). Gavian and Gemechu studied 14 commercial agriculture investors or entrepreneurs (see definitions in Box 3.2), five of which were IIS licensed. Gavian and Gemechu found that, first, the entrepreneurs employed (or were keen to employ) modern inputs such as tractors and threshing machines. Second, they also observed that there were high costs associated with business



legalisation, financial problems like acquiring capital, poor infrastructure and problems of pushing investors to go to hot, disease-ridden areas in the west and south of the country (Gavian and Gemechu, 1994).

**Box 3.2      The concepts of the entrepreneur and investor in the Ethiopian conditions**

According to Proclamation No. 37/1996 (FDRE, 1996a) an 'investor' was defined as 'a person or business who has made an investment ... to establish a new enterprise or to expand or upgrade one that already exists'. Also, as I will show later in this thesis, it is important to note that in Ethiopia ownership and management of an enterprise are often embedded in the same individual or a small group of individuals. But the notion of an investor, as it was understood in Ethiopia, was not compatible with the common definition of an 'investor'. For example, according to *The Collins English Dictionary* an 'investor' is someone who lays out and/or devotes money and resources to enterprises with the expectation of profit. Many Ethiopian investors (who set up, own and manage their own enterprises) go through the process of idea generation, resource mobilisation, and business legalisation. The notion of 'investor' was, therefore, limiting because it did not necessarily convey the characteristics of an individual or groups of individuals who set up enterprises.

The Ethiopian investment code understanding of an 'investor' was similar to the concept of the entrepreneur (entrepreneurship) defined, according to *The Collins English Dictionary*, as 'owner or manager of a business enterprise who, by risk and initiative, attempts to make profit'. In this thesis I used the concept of entrepreneur over 'investor' because it gave a better meaning to the role of the people who set up, own and run enterprises with the assistance of investment incentives.

What was most interesting about Gavian and Gemechu's study was that they asserted that IIS licensed entrepreneurs sought the IIS licence to be able to have access to bank credit and improve on their legal standing before the court (enforcing contracts, for example) (Gavian and Gemechu, 1994: 149-150).

However, what Gavian and Gemechu did not show was whether the IIS made any difference to entrepreneurial choices of location and type of activities in commercial agriculture and whether the IIS licence was used to provide entrepreneurs access to the most important resource, that is farm land.



To summarise, the above discussion showed that the IIS incentives were used to influence entrepreneurs' decisions over the size, location and sector of enterprises. Secondly, IIS benefits to the entrepreneurs also depended on the rates of both duty and income taxes, the type and location of activities. In short the IIS was meant to:

- support enterprise start-up: through subsidising imported capital goods by exempting entrepreneurs from the payment of import duties. As the findings of this study will show in chapter five, on the average eligible entrepreneurs benefit up to 13 per cent of the value of imported capital goods.
- support at early stage of enterprise growth: by granting entrepreneurs exemptions from the payment of 35 per cent of business income tax from one to five years (as of 1996) from the date of commencement of the enterprises. Entrepreneurs actual benefits from the scheme depended on the type and location of activities (as explained in Table 3.7 above).

Based on the above specifications, therefore, the core questions that this thesis has addressed were that: (i) did the investment incentives influence entrepreneurs' decisions on the choices of type, location and size of an enterprise (if so how)? And (ii) did the IIS licence serve as a gateway to resources like enterprise plots?

Section 3.5 below reviews non-IIS enterprise support initiatives and institutions that were running as of 1998.

### **3.5 Non-IIS institutions and instruments for enterprise development**

The review in this section covers enterprise services delivered by the government, non-governmental organisations (NGOs) and professional associations.

#### **3.5.1 Enterprise support institutions and services provided by the government**

##### **3.5.1.1 HASIDA/DAHSI**

Outside the investment incentives scheme by far the largest government run enterprise support institution was the development agency for handicrafts and

small scale industries (DAHSI). DAHSI's predecessor handicrafts and small-scale industries development agency (HASIDA) was set up 1977 marking a major shift in government policy towards the enterprise sector. It was following the set up of HASIDA that the 1966 investment code was scrapped by the Derg government because the code was incompatible with socialist enterprise organisation.

HASIDA was thus introduced to prevent the growth of capitalism in Ethiopia. Other justifications for HASIDA were that small scale industries and handicrafts generate employment, produce agricultural tools and implements and were considered as a means of mobilising indigenous capital for industrialisation. HASIDA was entrusted with the power to generate policy that promote and coordinate the development of small scale industries and handicrafts. It was also created to campaign against the cultural stigmatisation of communities that produce handicrafts.

HASIDA's support to small enterprises focused on providing vocational training and marketing skills and organising cooperatives of small scale industries and handicrafts. The approach was a more of a 'hands on' method of cooperativization which gradually led to fewer members staying in the cooperatives. The new agency, DAHSI, was set up in 1995 to assist and promote small scale industries and handicrafts. As in the past, training and research development were the main instruments of enterprise support. But unlike the Derg time DAHSI focused on individuals rather than cooperatives.

Apart from DAHSI promotional publications trying to portray some positive images emerging from their activities, data that showed the impacts of DAHSI activities were patchy. For example, between 1993 and 1997 a total of 591 people were trained in carpentry, bamboo work, textile production, weaving and spinning, metalwork and woodwork. Similarly between 1991 and 1995 another 557 people were trained in management (DAHSI, 1997: 14). Similar to many of the



other enterprise support beneficiaries, most DAHSI assisted trainees were from Addis Ababa and most of them were school leavers and the unemployed with limited resources for business start-ups. My overall observation was that given that trainees need other resources and conditions like finance to start up businesses, DAHSI efforts made only marginal impacts.

#### 3.5.1.2 Other enterprise related government agencies

**Specialised agencies for the development of the enterprise economy:** These included, first, the Engineering Design and Tools Enterprise (EDTE) that dealt with capacity building in the areas of:

- engineering design and manufacture of machine and equipment with the aim of producing better suited products for local small and medium industries,
- tool design (moulds, dies, jigs, fixtures, etc.) and tool making with the aim of creating a strong domestic technology base for industrialization,
- training national staff in the basic skills of product development, engineering design, tool design, prototype and tool making (Terefe, 1996: 49).

Second, the Science and Technology Commission (ESTC) was overseeing science and technology activities, promoting research including by providing small grants to research projects. Third, the Food Research and Development Centre, established in 1987, was working towards acquiring and adapting food processing technologies from the rest of the world (Terefe, 1996: 49). Fourth, the Ethiopian Management Institute (EMI) also had competencies in research, training and consultancy. However, this and the above institutions operations were very much limited to Addis Ababa region and/or focused on public sector enterprises.

**Enterprise agencies and programmes operating under sectoral ministries:**

Ministries like education, finance, industry, agriculture, energy, etc. influence enterprise policies and performance. For example, as of 1998 there were 17 vocational schools and institutions of higher education that had direct and



indirect contributions to the enterprise sector. But over 75 per cent of the graduates of higher institutions went to the public sector and the rest went to NGOs, large enterprises, and some remain unemployed. Wolde-Emmanuel (1996) reported that the private sector created about 2 per cent of jobs for 1994/95 commercial college graduates. He also noted that in the small enterprise sector employers took multi-purpose employees because specialists were often under-utilised.

**New and emerging enterprise support initiatives (as of 1998):** The Ministry of Trade and Industry (MTI) had some new programmes for the private enterprise sector. First, the micro and small enterprises agency has been set up by Regulation No. 33/1998 (COM, 1998a). The agency aimed at encouraging, assisting and coordinating institutions and initiatives oriented towards the micro and small enterprises sector. These were timely objectives as the development and delivery of none of the enterprise support initiatives were coordinated. Secondly, in 1998 an export promotion agency was set up to promote traditional and new export commodities. The export promotion agency also has a 'trade service point' for providing trade related information and facilitating import and export trade. With a view to setting up an industrial estate the government also made plots of land and premises available to the project. In agriculture a livestock marketing authority was also set up (Brook Debebe, 1999).

Proc. No. 103/1998 (FDRE, 1998a) allowed the set up of private capital goods leasing businesses. These businesses were believed to provide alternative sources of capital to the banks and address shortages of capital at enterprise start-up stage. Proc. No. 40/1996 (FDRE, 1996b) also provided the legal framework for the set up of micro financing institutions that extend credit to peasant farmers and entrepreneurs that set up small enterprises.

As of 1998 there were some studies in the making that were aimed at supporting enterprises. Two examples of these were (i) Enterprise Ethiopia - a programme designed to stimulate enterprise start-up, expansion and diversification (UNDP, 1998). (ii) setting up a seed capital fund to serve small scale enterprises to meet their financial needs at start-up (EIA, 1997b).

### 3.5.2 Non-Governmental Organisations (NGOs), Chambers of Commerce and Professional Associations

**Non-Governmental Organisations (NGOs):** such as Urban Development Support Service, Ethiopian Relief Organization, Redd Barna Norway, and African Village Academy and donors like the United Nations Development Programme (UNDP), and the European Union were providing limited support to the enterprise economy of Ethiopia. These NGOs and donors, for example, were involved in providing some credit schemes (Terefe, 1996: 50).

**Chambers of Commerce and Professional Associations:** Institutions like chambers of commerce and sectoral associations that promote the interests of the business sector were generally limited in number and services they deliver. Founded in 1947 the Addis Ababa Chamber of Commerce (AACC) was the oldest and relatively better organised. In 1998 there were 36,000 AACC members from the import and export trade sector, manufacturing and services (AACC Directory, 1998/99: 13). The Ethiopian Chamber of Commerce (ECC) was founded in 1978 and had members from 11 cities/towns.

Non-profit making associations of the private sector did not have a long tradition of association, nor had they enjoyed a supportive legal framework. It was only in the 1990s that professional associations began to emerge. According to Taye (1997) there were at least 67 non-profit making associations that represented the interests of the private sector. According to Borin *et al* (1994: 97-98) the contributions of these associations to their constituencies were limited to holding seminars and



exhibitions. Most did not participate in government policy making, lobbying and channelling of information. These professional associations were ineffective because of financial limitations, lack of office premises, lack of equipment and trained personnel.

### 3.5.3 Summary to Sections 3.4 and 3.5

Sections 3.4 and 3.5 showed institutions that were in the business of supporting enterprises and entrepreneurs over the study period (1992-98). The discussion showed some common elements about these institutions, that:

- institutions were limited in number and the type of services like training and finance they deliver,
- there was a lack of cooperation between support institutions themselves,
- supporting institutions tended to be concentrated in Addis Ababa,
- support (at least for major programmes like the IIS) was not demand driven, and
- support was single theme based like the IIS and DAHSI focusing on capital subsidy and training respectively.

The discussion above (and that given in section 1.2 in chapter one) showed that the IIS was an innovation when it was introduced in 1950. Since then (with the exception of 1975-90) the IIS has been a key economic and political policy for enterprise development in Ethiopia. Over the years the policy showed some changes: from inducing foreign capitalists to set up large manufacturing enterprises to assisting indigenous SME start ups in many activity areas. The policy also shifted in terms of purpose, for example, from simply encouraging enterprise start up to pursuing specific regional development objectives. The changes made to the IIS, however, were inherently piecemeal in nature, and most importantly, did not draw on other countries' experiences on local enterprise and SMEs development.



Over this fifty plus years an area where learning did not take place was in IIS's instruments of support - that is exemptions from paying duties and income taxes remained unchanged. The fact that EIA supported enterprises by augmenting capital invested meant that the entrepreneurs themselves were neglected. Physical assets, essential as they may be, would not be organised without the entrepreneurs. As I will show later, entrepreneurs faced constraints including inadequate infrastructure and finance. The IIS authorities failed to address these problems directly nor introduce innovative support measures that were tried and tested in the rest of the world. Section 3.6 below provides the overall conclusion of the chapter and makes links with the research propositions of the thesis.

### **3.6 Conclusion and links with the questions of the thesis**

In spite of its long history of indigenous culture, literature and government Ethiopia's continuous decline into abject poverty is puzzling. My background study showed that Ethiopia's past, its long and cherished independence also caused its isolation, resulting in marginal contribution of external knowledge and technology to the development of the country. Because education was either lacking or misguided it failed to play a role in development either in providing skilled personnel or a means to challenge undesirable cultural practices. Sustained hostility to major innovations and/or foreign technology partly created the current barriers to the development of dynamic enterprises and institutions.

In recent years government development policies too were misguided as, for example, the Derg's policy which stifled the development of the private sector as a matter of policy. In the 1990s the enterprise sector was dominated by less value adding small producers. Linkages between different sizes and groups of enterprises were very weak. And business relationships like subcontracting and franchising hardly existed. Consequently opportunities for technology transfer and creating more jobs and value added were limited. Backward technology and

poor infrastructure including roads, energy and marketing arrangements were major bottlenecks to enterprise start-up and growth. But still there is some potential for enterprise development such as low wage labour, land and land based resources. An enabling macro-economic framework was a positive development for the business sector.

From the discussions above and that presented in chapter one (section 1.2) it can be concluded that Ethiopia's enterprise policy in the early 1990s failed in two main areas. First, it failed to address problems of SMEs like finance, access to energy sources and plots of land. And second, it failed to learn from other countries' experiences on local enterprise and SMEs development and introduce policies that worked for SMEs. Instead Ethiopia's main enterprise initiative (the IIS) regressed, and was reintroduced in the same way as it had been in the 1950s. It is against this background that the subsequent chapters will show how these narrowly defined IIS policy and instruments failed to impact on SMEs start up and early growth.

## 4. Research Strategy and Methods

### 4.1 Introduction

The thesis is based on multiple sources of data including macro statistics and evidence from an in-depth study of selected sample of SMEs. This chapter outlines the rationales for the contrasted sources of data, and describes how data collection and analysis methods were selected and employed<sup>37</sup>.

Section 4.2 below discusses the reasons for using the different sources of evidence. The design and implementation of case studies required careful consideration of how to generate sufficient and reliable data. Section 4.3, therefore, particularly reports on the procedures and criteria used in selecting a sample of SMEs. In section 4.4, I discuss the basis of selection and types of data collecting methods and procedures used. I also document here my experience of the fieldwork. Section 4.5 briefly considers the analytical methods used in the analysis and discussion sections of the thesis. Finally section 4.6 provides a brief chapter summary.

### 4.2 Considerations made in choosing research strategies

There is a degree of confusion in the use of some terms in the research methods literature. The particular terms referred to here are those associated with the general route taken to conduct research, variously dubbed research style or approach (Bell, 1993), strategy (Yin, 1994 and Robson, 1993), paradigm (Guba, 1990), and approach or framework (Thomas, 1998). With a view to avoiding such multiple (and sometimes confusing) terms, following Robson (*ibid*), I have used the term 'strategy' to mean the general route taken to address research questions

---

<sup>37</sup> For the purpose of this thesis the case for both qualitative and quantitative data was compelling. However, because of its limited relevance, this section will not discuss the theoretical perspectives of positivists and constructivists on quantitative and qualitative data.



(as in involving the choice between case study, survey, experiment or archive based information). A research 'method' here refers to specific device or 'tactic' of data collection and analysis (as in interviewing and data organisation).

The rest of this section focuses on, first, the basic parameters considered in choosing research strategies. Section 4.2.1, therefore, explores the link between the research questions and hypotheses and the possible research strategies. In section 4.2.2 the strengths and weaknesses of the research strategies employed in the study are carefully assessed and discussed.

#### 4.2.1 Linking research strategy and questions and hypotheses

As highlighted in the earlier chapters, two major reasons justified the conduct of this research. First, investment incentives as an idea of enterprise support initiative was a contested concept. And, second, barely any empirical study was available on the role and impact of the IIS on enterprise start-up and growth. Hence the research specifically set out to explore the relationship between investment incentives and enterprise start-up and growth in the Ethiopian context. From these premises, two focal areas of research emerged:

- (i) **the theoretical concern about investment incentives and the assumptions taken by IIS policy makers:** How did investment incentives influence entrepreneurs' decisions on, for example, location and size of enterprises (if indeed they did)? From the literature reviewed (chapter two) it is apparent that investment incentives may have worked in some developed countries but not in some less developed countries. But in Ethiopia the authorities kept granting investment incentives to entrepreneurs believing that these incentives influenced entrepreneurs' decisions over choices of the type, location and size of enterprises. Government statistics showed that 4246 projects were licensed for the IIS over the period 1992-98, and of this total 1163, a little more than a quarter, were set up. However, some nagging questions remained unanswered, like did the IIS really

provide support to the entrepreneurs and switch entrepreneurs' decisions on the type and location of enterprise start-ups?

Based on the broader literature reviewed on the effectiveness of the investment incentives (chapter two) and the preliminary evidence collected from Ethiopia (section 4.3 below), I was sceptical about the possible impacts of the IIS, as reflected in hypothesis one (H1):

- H1: the influence of investment incentives on the timing, type, location and size of IIS assisted SMEs was limited.

This hypothesis, as will be explained later, was subjected to thorough exploration.

(ii) **the mediating role of the IIS:** my scepticism about the IIS impact raised another set of questions: if the IIS was less important in influencing entrepreneurial decisions, then why did the authorities keep providing (and some entrepreneurs keep seeking) its support? Asking these questions may appear naive because, it could be argued, the IIS authorities may have continued delivering the IIS support as they did not know it had little impact on enterprise start-up. However, these questions were asked because, as the discussion below shows, the authorities were providing preferential access to other benefits for IIS participants.

Prior to the extensive field work in 1998, I conducted a preliminary study that involved visiting some enterprises and institutions most related to the IIS operations. From this preliminary study I noted that, in addition to subsidising investment capital on machines, some entrepreneurs used the IIS licence and structure to get easier and cheaper access to enterprise sites, bank credit and utilities. Moreover, it appeared that some entrepreneurs used the IIS structure to ease the bureaucracy of business legalisation. From this observation a second hypothesis emerged: if IIS mediated benefits were in part or fully captured by the entrepreneurs, then enterprise start-up pace, size and location could be affected,



perhaps significantly. Based on this grounded exploration of how the IIS system influenced entrepreneurial behaviour on the take-up of IIS support, I encapsulated the gist of the arguments in hypothesis two (H2):

- H2: some entrepreneurs sought the support of the IIS, in addition to its fiscal benefits, for its role as a gateway to resources (land, credit and utility) required for enterprise start-up, and to ease the otherwise bureaucratic business legalisation processes.

I will also argue that these non-IIS benefits are far superior to benefits that emerge from investment incentives. Furthermore, an in-depth exploration into the question of why entrepreneurs needed the IIS licence and structure to get access to land and credit also reveals some interesting insights into the workings of the enterprise economy.

Before I embarked on the search for empirical evidence that answered the above questions, I developed a conceptual framework (chapter one, Figure 1.1) that showed the IIS system, including its key component of assisted entrepreneurs/enterprises, and the environment it operated in. The conceptual framework also guided the study on aspects of the non-IIS benefits (as well as disentangling this from IIS benefits) that some assisted enterprises drew on. For example, providing assisted enterprises with easy or subsidised access to serviced enterprise sites was never part of the IIS function. However, following hypothesis two (H2), it had now become an IIS mediated benefit to some participants.

To assist the enquiry questions like what were the rationales for initiating the IIS, what were entrepreneurs' motives for decisions on enterprise start-up in relation to the use of the IIS, and why did the entrepreneurs seek non-IIS assistance were asked (see Appendix 1). Because the foregoing, largely 'why', 'how' and 'what' questions, lead to a rigorous exploration of the issues (Yin (1994), Miles and Huberman (1994), and Thomas (1998)) a case study research strategy was chosen.



The SME literature too upholds a case study research strategy because it enables an in-depth enquiry into the impacts of a given support system:

[I]t is only by means of in-depth discussion with small business owners that the effectiveness of policy initiatives can be judged (Bridge *et al*, 1998: 217).

However, for the reason given below a survey based research strategy was not appropriate.

**Reasons for not using a survey research strategy<sup>38</sup>:** As Box 2.1 in chapter two showed, SMEs as units of analysis are heterogeneous and limit generalisation from cases studied to the population. The large sector and spatial diversity of Ethiopian SMEs, therefore, meant that a significant size sample survey had to be conducted. However, there were several limitations to conducting a survey: first, generating data based on a survey research strategy would have been limited by a number of difficulties that are very much to do with the heterogeneous characteristics of entrepreneurs and SMEs. With limited time and resources available for the study, generating a sufficient number of SMEs to represent, among other things, sector, region and size criteria would have been difficult.

Second, the physical and social infrastructure of Ethiopia, discussed in chapter three, would have barely supported a survey strategy. For example, owing to the unreliable means of communication (postal, telephone, and roads), sample survey responses would have been low. Moreover, poor survey responses would be likely to be biased in favour of large enterprises which often were owned/managed by relatively educated personnel. Researchers' experience (for example, Workie, 1997) also suggested that many IIS assisted entrepreneurs were

---

<sup>38</sup> Note that the core questions of the research did not necessarily require the use of a survey research strategy. It was possible to address most of the questions using a small sample of case SMEs and other data sources, including macro data.

least likely to have provided (or kept) sensitive data on taxes (including that paid and saved due to the IIS).

Finally, a sample survey presupposed a known population of enterprises.

Although recent statistics give estimates, at the start of this research there was no knowledge of the population size of Ethiopian enterprises in general and those supported by the IIS in particular. These problems, therefore, would have made the process of drawing a sample and subsequently making a meaningful analysis of data a rather precarious exercise.

All the foregoing, therefore, meant that a closer contact and a thorough enquiry of selected cases were essential. Therefore, acknowledging the need for more macro based data and the limitations of a survey strategy, I decided to generate primary and secondary data from multiple sources as outlined in section 4.2.2 below.

#### 4.2.2 Foundations of using mixed research strategies

The literature (for example, Yin (1994) and Robson (1993)) suggested that sources of evidence such as surveys, case studies and archive information constitute research strategies. Table 4.1 shows a mixture of these strategies that were employed in this research. While using these sources of evidence I have taken into account several factors including: the nature of the research questions and hypotheses, practical limitations of conducting a survey, the fact that the research context was Ethiopia where the infrastructure was limited, and resources available to me within the scope of the research project.



**Table 4.1** Strengths, weaknesses and complementing research strategies used in the research

strategy/source of evidence	strengths	weaknesses	complementing strategy
macro data	showed some characteristics of population of IIS licensed enterprise (dynamics of start up: activity type, location, etc.), and stages of start ups	weakness on what switches entrepreneurial choices, did not answer specific questions related to IIS	use data from land lease and inland revenue offices, use case SMEs and stakeholders interview data
past survey results	showed entrepreneurial characteristics of the population	did not show entrepreneurial response to IIS incentives	use case SMEs and interview other stakeholders
IIS policy documents	showed historical developments (eg. changes in the incentives structure and role of the private sector)	did not provide enterprise level data	use macro, case SMEs, etc. data
interview key stakeholders	showed IIS providers and other stakeholders perspective on IIS impacts	may be subjective	use as many stakeholders as possible
selected sample of SMEs	showed entrepreneurial decisions, enterprise start up processes and constraints and levels and impacts of IIS	restricted generalisability	use past survey data and/or macro data including inland revenue data on revenue foregone due to the IIS

*Source: Own Construction*

The strengths and weaknesses of each source of evidence are briefly described in Table 4.1. In addition below I briefly comment on each source of evidence. Macro or national data provided information on the population of the research - that was all IIS licensed projects over 1992-98. These data showed, among other things, the spatial and sector patterns of the IIS supported enterprises. The interpretation of these macro level data were enriched by the interviews conducted with what I



referred to as stakeholders. These stakeholders included representatives of IIS policy makers and staff of EIA, regional investment offices, professional associations and representatives of institutions like the Land Lease Office. These stakeholders had professional interest, as promoters or collaborating supporters of enterprises, in influencing the application and effects of the IIS. Archive based information, notably that related to IIS policy documents, provided vital information on the evolution of the scheme.

Finally, using a selected sample of SMEs enabled me to carry out a rigorous enquiry into how the IIS support initiative worked and impacted on enterprise start-up at different stages. By combining entrepreneurial features from past surveys, I was also able to anticipate entrepreneurial responses to IIS incentives. Moreover, three of the six case studies were unassisted enterprises which helped to me to study (a) the difference that the IIS support makes to enterprise development and (b) the state of enterprise development immediately outside the IIS system boundary.

To sum up, these multiple sources of evidence provided me with a unique opportunity to generate diverse qualitative and quantitative data on how and when events such as enterprise start-up took place. Furthermore, these sources provided data that describe and interpret events in such a way that each source can confirm or challenge conclusions emerging from others.<sup>39</sup>

Unlike the more straightforward collection of macro data and the interviewing of IIS authorities, the design, selection and data collection from the case studies required some careful procedures. Section 4.3, therefore, specifically discusses the procedures and criteria used in SME selection.

---

<sup>39</sup> Details of legal and statistical documents and interviewees are given in sections 9.2, 9.3 and 9.4, respectively, of the Reference section.

### 4.3 Procedures and criteria for selecting SMEs

#### 4.3.1 The preliminaries of case study selection

In early 1998, a pre-fieldwork exercise was conducted with a view to: (i) selecting enterprises to feature in the study, (ii) determining the procedures for approaching enterprises, (iii) testing the feasibility of interview questions and the subsequent recording and processing procedures of data, and (iv) collecting data that included macro statistics on IIS supported enterprises.

The preliminary fieldwork proceeded in steps, first, by describing the wider socio-economic environment, and subsequently identifying beneficiaries of different enterprise support initiatives like the IIS and DAHSI (as discussed in chapter three). Further, preliminary data on IIS assisted enterprises (including regional and sector dimensions) were collected. Subsequently, classification and preliminary analyses were conducted to show enterprise size, age, sector and location patterns. One key preliminary finding was that, in 1998, there were over 1000 small to large enterprises thought to have been set up with IIS support. The question then followed, which and how many of these enterprises should feature in the study?

Following the reasons given in section 4.2, I decided to conduct a study of a selected sample of case SMEs. The subsequent question was selecting what Thomas (1998) referred to as 'challenging cases' - those cases with limited scope but informing the whole area of IIS policy. In other words, and complementing other data sources, I wanted to focus on a few cases, each serving as an instrument not for its own sake but to address the bigger IIS policy issues, as the literature suggested (Stake, 1995: 3).

Further, before deciding on the categories and number of enterprises that would feature as case SMEs, I also stated certain conditions relevant for selecting the cases:



- the cases should address key IIS assumptions/objectives - that is, the case enterprises should reflect on the expectation that the IIS support might produce differential sectoral and regional benefits and impacts. This meant that the cases needed to be drawn from the categories referred to as 'pioneer' and 'promoted' activities (as defined and discussed in chapters one and three).
- the preliminary enquiry (also see section 4.3.4) found that many entrepreneurs, for example as many as two out of three in Addis Ababa, that would have qualified for IIS support were successfully starting up enterprises without support. This raised the question of why some entrepreneurs sought IIS support to start up enterprises, while others went it alone. The question led to the inclusion of some unassisted enterprises (UEs) as case studies.
- other factors that had a direct bearing on the choice of case enterprises such as size-age criterion were taken into account.

The inclusion of enterprises that qualified for the IIS support but did not take licences (UEs) in the study served some key purposes. First, UEs enhanced the assessment of the effectiveness of the IIS including in addressing issues like deadweight and displacement, and stages in the adoption of IIS subsidised technology. Second, in line with H2, UEs provided more information on how non-IIS institutional support (that some AEs enjoyed) impacted on enterprise start up. Using UEs as a device, these non-IIS institutional supports offered to AEs were disentangled from IIS benefits and thereby the performance of AEs were assessed on the basis of the total public support they enjoyed. The inclusion of UEs in the study, therefore, has enhanced the possibilities of making broader generalisations about the IIS direct and indirect impacts.

#### 4.3.2 SME age-size criteria

Following the Ethiopian definition of enterprise size (see chapter two, Box 2.1), a typology of enterprises was developed. The typology, which applied to all types of activities, was:



- micro enterprises (up to five employees)
- small enterprises (6-15 employees)
- medium-sized enterprises (16-50 employees)
- large-scale enterprises (greater than 50 employees)

Following the underlying reasons for studying SMEs, outlined in chapter one, the cases came from small and medium-sized enterprises (SMEs) which employed 6-50 people at the time of start-up. These SMEs were indigenous and eligible for IIS support.

It is already stated that the first IIS law goes back to 1950. But I fixed the timescale of this study to cover 1992-98, that was the period since the IIS was reintroduced in 1992. The choice of this period was based on, first, enterprises which enjoyed similar IIS support in the pre-1974 environment were nationalised and some of the first generations of owners and managers were unlikely to be available for the study. Second, I also believed that only if enterprises were fairly new would owners be able to remember and reflect on events that took place at the time of set-up and subsequent development of the enterprise. Third, I also thought that a close SME age cohort that operated in a similar macro environment would deal with confounding factors such as differences in age and policy environment.

Finally, I have also avoided selecting SMEs which had just commenced operation because of the possible difficulties in identifying the benefits of the IIS right after start-up. Therefore, the selected case SMEs were those set up since 1992 and in 1998 at least two years old.

#### 4.3.3 Number, activity type and location of case SMEs

**Sector composition and number of case SMEs:** following a careful application of the criteria set out above I finally decided to study six SMEs three of which were AEs and other three UEs. These SMEs were carefully chosen (see section 4.3.4 below) and represented activities that the IIS authorities referred to as 'pioneer'

(like engineering industry), 'promoted' (such as consumer goods industry) and those in between 'pioneer' and 'promoted' (those that combined agro-industries and services). In my decision on the number of SMEs I took into account the cooperation of entrepreneurs<sup>40</sup>. This was because experience (for example, Workie, 1997) showed that some entrepreneurs did not cooperate with researchers and were not used to intensive qualitative research.

**Location of case SMEs:** The six SMEs were drawn from the Addis Ababa region. Choosing the location of these SMEs, as the discussion below shows, was a complicated matter that rested on several considerations.

To begin with, in theory the IIS was expected to encourage enterprise start up within a particular region and/or cause inter-regional movement of capital investment, that is from least IIS-assisted to most assisted areas. The study addressed the possible increase in enterprise start up in a particular region in different ways. First, macro data that related the regional distribution of start ups and IIS benefits, that is revenue foregone due to the IIS, were used. Second, an in-depth study of data from Addis Ababa, Addis Ababa-Nazareth corridor and Oromia regions was made<sup>41</sup>. In addition to these statistics the extensive interviews I had with the IIS authorities from Addis Ababa and Oromia regions provided evidence to assess the location impacts of the IIS. Third, following the selection of case SMEs, I also discovered that four of the six selected enterprises had significant operations in at least one region outside Addis Ababa. Hence founders

---

<sup>40</sup> Anticipating that some proposed SMEs may refuse to be involved in this study a reserve list of SMEs was produced. As expected one enterprise pulled out because its operation was hugely affected by the then Ethio-Eritrean conflict. This enterprise was replaced from the reserve list.

<sup>41</sup> These areas have had significance in IIS and non-IIS assisted enterprise development in the country. And these areas also have had contrasting features: the Addis Ababa and Addis Ababa-Nazareth corridor were the least IIS assisted areas, while the Oromia region covered least IIS assisted (Addis Ababa-Nazareth corridor) and most IIS assisted areas like the Borena zone.



of these SMEs were also asked whether their operations outside Addis Ababa were related to IIS incentives.

Moreover, as the subsequent chapters will show, the choice of SMEs from Addis Ababa was influenced by the particular significance that the authorities attached to inter-regional movement of capital investment (often from Addis Ababa to the other parts of Ethiopia). My extensive consultations with EIA members of staff revealed some limited inter-regional investment capital movements. Examples of this included (i) cases in which some entrepreneurs from Addis Ababa that set up enterprises along the area commonly called as the Addis Ababa-Nazareth corridor, and (ii) land-based enterprises that were set up in the regions such as Afar in the east and Metema and Humera in the northwest of Ethiopia. However, my consultations with EIA members of staff did not result in suitable cases for this study. This was largely because the Addis Ababa-Nazareth corridor received similar level of IIS incentives as the Addis Ababa region and had more or less similar infrastructure and market potentials. The few entrepreneurs who set up farms in remote parts of Ethiopia needed the hot climate and tracts of land that Addis Ababa could not have provided. These meant that an outflow of investment capital from Addis Ababa had little to do with the limited IIS incentives provided in the region.

Furthermore, the selection of location of case studies was considered in conjunction with issues of industry choice and size that the thesis pursued. For an entrepreneur from Addis Ababa, while location based IIS incentives suggested moving out to the regions, industry choice (like engineering firms) and enterprise size, among other things, required better infrastructure and a larger market hence these tended to keep enterprise start-up within Addis Ababa. Based on these broader considerations, therefore, I was convinced that an entrepreneur from Addis Ababa would face the most challenging enterprise start up decision: should



he/she seek the best IIS location based incentives at the expense of better infrastructure and market in Addis Ababa?

Finally, enterprise start up in Addis Ababa had some unique features too. For example, in terms of submitting proposed projects for IIS support, Addis Ababa had the highest share of projects relative to the other regions (40 per cent over 1992-98) but project implementation rate was the lowest due to the political economy of non-IIS incentives distribution (including the provision of access to land and utilities). Issues around non-IIS incentives relates to the concerns of hypothesis two. Therefore, with a view to thoroughly exploring both H1 and H2, investigating SMEs start up in Addis Ababa was considered the best approach.

In short the foregoing sections set out the scope and criteria of selecting case SMEs. The next section deals with how the cases were actually selected.

#### 4.3.4 Selecting 'challenging' cases of SMEs

Depending on the circumstances, the literature (for example, Langrish, 1993) suggested approaches such as looking for comparable units (age, size, etc.), 'best practice', and consulting informed people to generate cases for a study. However, with only patchy information on the whereabouts and features of Ethiopian enterprises, these approaches were unlikely to produce cases with the above required features like size and age. My first thought was taking a direct approach which envisaged visiting enterprises until suitable cases emerged. However, this option was quickly ruled out as it was an inefficient option in terms of time and resource use. The second and favoured approach to selecting cases from a large and chaotic sector of SMEs was, therefore, to proceed with the construction of a

list of potential case studies based on information (however inadequate) from directories<sup>42</sup> and databases of government departments.

The case study SMEs were finally drawn from the enterprise summed up in Table 4.2. The table shows the number of enterprises set up or those which became members of the Addis Ababa Chambers of Commerce (AACC) between 1992 and 1998. Over 1992-98, the total number of IIS supported and successfully started enterprises in Addis Ababa was 165 (of which two were micro enterprises that employed less than six people). The data summarised in Table 4.2 suggested that EIA, through the IIS, assisted small to large enterprises, and notably medium and large ones. In total, 110 or 67 per cent of the AEs met the criterion of an SME<sup>43</sup>. It was also found that over three quarters of these AEs engaged in the manufacturing sector (where 30 per cent of these manufacturing AEs were in the footwear industries). Most of the large enterprises tended to be in the construction industries, and large AEs, as they were in Addis Ababa, were not typically that numerous in the rest of the country.

---

<sup>42</sup> The two most relevant business directories were the Addis Ababa Chambers of Commerce (AACC) and the Federal Ministry (and Addis Ababa Regional Bureau) of Trade and Industry (MTI). The AACC directory *Addis Ababa Business Directory, 1998-99* (AACC, 1998), had over 36,000 businesses from trade, manufacturing, and service sectors. The MTI *Directory of Private Industries in Addis Ababa* (MoI, 1993), listed 3691 small to large manufacturing enterprises. In the MTI directory, names and addresses of enterprises, and labour force and capital, and the line of activity and production capacity was provided. However, for the purpose of selecting cases for the study both AACC and MTI directories had serious limitations. The MTI directory in particular was out of date. Neither sources provided information on the age-size measures of a enterprise nor whether an enterprise received IIS support or not. Neither directory, therefore, was used for the purpose of selecting the cases.

<sup>43</sup> As discussed in chapter one, the proportion of SMEs in the total AEs was more than 80 per cent (that is more than 67 per cent ratio I found for Addis Ababa). This was because enterprises that set up outside Addis Ababa on the average were much smaller.



**Table 4.2 Sample frame summary: number of enterprises established (and/or members of AACC) between 1992-98 in Addis Ababa**

Source of data	small	medium	large	total
EIA	27	83	53	163
TIB	269	90	31	390
AACC	-	-	-	537

*Sources: Unpublished data, EIA (March, 1998); TIB (March, 1998); and AACC (March 1998)*

AACC and TIB data covered enterprises with employment size greater than or equal to six. TIB data showed 31 enterprises that employed more than 50 people; and 12 of the 31 enterprises employed more than 100 people. Most importantly, EIA and TIB sources suggested that roughly one in three of SME start-ups were recipients of IIS support. AACC data, which needed adjustment for double counting, showed 537 enterprises registered since 1992. The number of enterprises (summarised above) in spite of some limitations<sup>44</sup> was the best at the time and, therefore, was used to guide the selection process of case SMEs.

The final list of SMEs selection also considered issues like the availability of information such as the precise enterprise location (address), enterprise size and year of establishment, and ease of physical access to enterprises. In particular selecting UEs was more problematic than AEs as verifying the application of the 'minimum investment capital' criterion (*birr* 250 000 as for the AEs) at start-up was difficult to substantiate. It was only through subsequent visits that I was able to verify that the chosen UEs did fulfil the 'minimum investment capital' criterion, a criterion so important in determining entry into the IIS system.

---

<sup>44</sup> EIA sources tended to produce more 'large' enterprises. This was partly due to (i) the fact that AEs in Addis Ababa included all sectors, and (ii) it appeared that some AEs reported more jobs perhaps in order to get priority for support. But when enterprises commenced operation (and registered with TIB) they tended to be smaller than shown in plans or shortly after start up. AEs could have easily been in both AACC and TIB databases.



Table 4.3 shows some of the features of the selected six cases of SMEs. Note that, first, AE1 and UE1 came consumer goods manufacturing industries (footwear industry); and AE2 and UE2 from engineering enterprises that were likely to be investment capital intensive. Finally AE3 and UE3 came from the agro-industries and services that included road transport.

**Table 4.3      Some features of cases of SMEs**

enterprises	year of start up	size at start up (jobs)	legal form	zone in Addis Ababa
Footwear Factory (AE1)	1992	8	SP	5
Footwear Factory (UE1)	1992	6	SP	14
Engineering enterprise (AE2)	1994	30	PLC	18
Wood/metalwork enterprise (UE2)	1992	40	SP	7
Agro-industrial and Commercial Company (AE3)	1995	26	PLC	25
Chemicals and Trading Company (UE3)	1992	18	PLC	19

*Source:      Own Construction (based on information supplied by the entrepreneurs)*

Second, these SMEs were not equal or identical. All enterprises differ in terms of their staple products/services, establishment time, or the characteristics of the people who own/manage these enterprises. Third, the legal form of organisation of these SMEs (column 4) was PLC and sole proprietors (SP). AE2, AE3, UE2 and UE3 had significant operations outside the Addis Ababa region.

Section 4.4 below discusses the data collection methods used, and reflects on my experience of the field work.

**4.4            Methods of data collection and conducting the fieldwork**

**4.4.1        Choosing data collection methods**

The preceding sections clearly suggested that the study required the generation of both quantitative and qualitative (or behavioural) data. The search for

quantitative data focused on both the cases of SMEs (like resources of entrepreneurs) and macro statistics on outcomes of the IIS (like the number of new enterprise start-ups and jobs created). Similarly, qualitative data referred to responses of the authoritative individuals and case SME entrepreneurs about the IIS rationale and impacts and motives for starting up enterprises.

To generate these data, first, macro statistics were collected from the relevant government agencies (like EIA). Second, survey reports were purchased from Central Statistical Authority and/or from the relevant agencies. Third, from the libraries (National Library, Addis Ababa University, Commercial College of Addis Ababa, and EIA) IIS and enterprise development related archive information were generated.

To capture behavioural responses a face-to-face semi-structured interview method was conducted. To this end an interview questionnaire was prepared (Appendix 1). Most of the interview questions focused on the road that entrepreneurs took to enterprise start-up, and entrepreneurs' and authorities' view of the IIS influence on enterprise start-up and growth. Most of the behavioural type interview questions such as 'what motivated you to set up this enterprise?' were open-ended, that is the questions did not limit responses of entrepreneurs. Moreover, as per the foundations of the thesis, questions explored the processes and constraints of enterprise start-up and/or licensing for the IIS.

Although a time-consuming exercise, the semi-structured interview method had advantages over other methods like a self-administered questionnaire, because a semi-structured interview was flexible in wording and ordering of questions, and follow-up of responses (Robson, 1993: 229). Moreover, particularly in the Ethiopian setting and with limited time and resources, the best method of ensuring quality of work and response rate was to establish a direct contact and undertake face-to-face interviews with the entrepreneurs and authorities.

#### 4.4.2 Testing for interview questions and interviewing procedures

Prior to embarking on the fieldwork, as outlined in section 4.3.1, aspects of the interview questions and interviewing procedures were subjected to testing. Key areas of testing focused on clarity, wording and sequence of interview questions, time required for interviewing and recording responses, and access procedures to SMEs and institutions. Consequently, owner-managers of AE1 and UE1, two officials from the then Ministry of Economic Development and Cooperation (MEDAC) were approached, and the tests were carried out. All the visits went well and produced useful lessons including that:

- there were indications that proposed SMEs' addresses, taken from business directories and government departments, were unreliable. Consequently, more information was needed to make contacts with the SMEs.
- access to and cooperation from the entrepreneurs required support facilities like a 'to whom it may concern letter' to introduce myself, the research project, and the institution that I was affiliated to. Subsequently, during the fieldwork supporting letters were used (Appendix 2).
- it emerged that some respondents did not speak English, therefore, interview questions originally set in English were translated into Amharic.
- the preliminary visit also suggested that questions that sought behavioural responses needed recording on tapes whereas quantitative data could be filled in on pre-prepared forms. A practice recording of interviews on a portable machine was also carried out.

After making these corrections I set out to conduct the main fieldwork.

#### 4.4.3 The main fieldwork

Between July-October, 1998, the main fieldwork was conducted. Data, as per the plan, were collected from owner-managers of six SMEs, and most senior members of the agencies that were directly or indirectly related to enterprise development. These agencies included the Ethiopia Investment Authority (EIA), Development Bank of Ethiopia, Addis Ababa Land Lease Office, Ethiopian Electric Power



Corporation, and Addis Ababa Private Industries Association. (A list of names of interviewees and institutions that took part in the study is provided in Section 9.4).

Further, as per the plan, primary data was obtained through a pre-prepared interview questionnaire that was partly recorded on tapes and partly filled in on forms. Large sets of macro data on investment licence holders were generated from national and some regional level investment offices. Finally, national survey reports that showed different aspects of enterprise development, and relevant published and unpublished government department data on enterprise development were collected. Of this later information the most relevant were the laws and regulations about the incentive system that date as far back as the 1950s.

Interviews with all the entrepreneurs except AE3 and UE2 were recorded directly on tapes. Interviews made with AE3 and UE2 were recorded on paper because the entrepreneurs were not happy to leave information on tapes.

There were, however, several problems faced while conducting the fieldwork. I have already said that addresses were not always accurate; more often telephone numbers did not work or when working they failed to connect the businesses registered to the phone numbers. Second, obtaining data from SMEs was not easy due to some entrepreneurs' fear of giving away tax-related information to tax authorities. Third, the entrepreneurs were suspicious of outsiders (including myself) mainly taking them as competitors in their trade. Fourth, it took a long time to see or talk to people in charge of the SMEs involved. While some entrepreneurs were genuinely too busy to respond to questions, others did not seem to understand the value of the information to the research project. I assured

entrepreneurs that the data they gave would be kept in confidence (Appendix 2).<sup>45</sup> Moreover, over July-October 1998 I spent sufficient time getting to know and establishing trust with the entrepreneurs.

Access to public institutions (such as EIA, OIO and AACC) was smoother except for the extensive security check (mainly related to the then Ethio-Eritrea conflict) at the gates of public premises. Officials of public institutions (especially at EIA) provided full co-operation to the research project. Two members of EIA's statistics division in particular collected and organised information on revenue foregone due to IIS from the Customs Office to the benefit of this study.

Section 4.5 below briefly discusses the methods used in the analysis and discussion sections of the thesis.

#### 4.5 Analytical methods

In the thesis different analytical methods were used. First, interview tapes were transcribed and documents were translated from Amharic into English. Subsequently, various methods<sup>46</sup> of data organisation and analysis were used. Methods that describe, group and compare large enterprise data such as by location were used. Then from such quantitative data tables were produced. From qualitative data summaries and themes were generated. Then confirmation and exploratory analyses were performed by subjecting data sources to triangulation.

---

<sup>45</sup> Accordingly, at their request, names of entrepreneurs and enterprises of AE<sub>1</sub> and UE<sub>1</sub> have been kept anonymous.

<sup>46</sup> Institutions like UNCTAD (1996) tend to prescribe social cost benefit analysis (SCBA) to measure the efficiency of an incentives system. However, this study has found the SCBA method less relevant and applicable. SCBA looks into the wedge between social and private benefits to justify support and/or success of an incentives system, in effect leaving out behavioural influences of the IIS. Secondly, SCBA requires a large volume of quantitative data, and some of these data (like the opportunity cost of labour and capital; and environment) were difficult to generate.



As has been discussed so far the thesis was constructed around two central hypotheses, which from a methodological point of view, provided clarity and focus to the enquiry. However, the hypotheses were not tested using statistical inferences. Instead the hypotheses were explored using a range of evidence including opinions of users and providers of the IIS, independent observers, unassisted entrepreneurs, macro statistics that showed, among other things, location and activity types of enterprise start-ups related to the IIS. To support the conclusions I also drew on other research findings and theory.

The thesis combined quantitative and qualitative evidence to specifically study, among other things, the following key areas:

*(i) investment incentives and the process of enterprise start-up*

The link between investment incentives and enterprise start-up is key to the enquiry. However, more than the simple incentives-start-up (input-output) relationship this thesis gave profound importance to the *process* of enterprise start-up. This was because an input-output study conceals many of the constraints that entrepreneurs face in the process of enterprise start-up that a support initiative ought to have addressed. Consequently, in this thesis I explored the influences of the IIS on the process of enterprise start-up by identifying the following stages and processes:

- enterprise idea generation leading up the stage of acquiring an IIS licence,
- setting up and completing physical construction (or implementation) of a project, and
- commencing producing goods and services.

The discussion in chapter six uses the model on stages of the enterprise start-up process (from idea generation to implementation and early growth).

*(ii) the importance of institutions and political decision making*



Hypothesis two (H2) took the thesis beyond the narrow IIS system boundary and showed that some SMEs sought the IIS support to capture other superior benefits. These superior benefits were provided by the non-IIS government agencies at different levels: some received subsidised access to government controlled resources like land; others used the IIS to overcome the otherwise onerous bureaucracy of resources mobilisation. For a better understanding of how an enterprise support initiative like the IIS works, I therefore gave focus to the role of institutions and the politics of it. In this regard, following Schaffer and Wen-Hsien (1985), in chapter seven I used a model that portrayed the political economy of access to public services by SMEs entrepreneurs.

*(iii) enterprise support output and impact*

This thesis, as stated from the outset, is a study of roles and impacts (intended and unintended) of the IIS on enterprise start up and early growth. An impact study of a support initiative, as argued in Chen (1990), has to establish two conditions. Of these, the first and necessary condition, is the presence of outcomes associated with a particular support initiative (in the IIS context this includes outcomes such as numbers of enterprise start-ups). The second and sufficient condition of impacts study is establishing the presence of causal relationships between outcomes (including unintended outcomes) and the content of support (the investment incentives). The thesis, therefore, in addition to the direct impacts of investment incentives, investigated the consequences of the mediating role of the IIS. Finally, following the literature reviewed in chapter two, I have questioned whether the provision of the IIS had sound rationales.

#### 4.6 Chapter summary

The nature of the questions and hypotheses that this study raised required reasonably adequate and reliable data on enterprises. Unfortunately such data on Ethiopian SMEs were scarce. Because of the large spatial and sectoral diversity

between enterprises, among other things, I was also not able to conduct a survey. Therefore, generalisations made in the thesis were based on evidence originating from multiple and complementary sources.

Reflecting on the types of activities and locations that the IIS provided support to, six carefully selected SMEs were used as cases. To complement evidence from case SMEs, national statistics (that showed, among other things, the regional distribution of enterprises and IIS licensed projects and start ups), archive information and past surveys results were used. These sources of data put together provided sufficient and reliable evidence to make some generalisations about the nature and impacts of the IIS on SME start-up and early growth. Chapter Five presents the findings that emerged from some of the sources of data outlined above.

## **5. Main Findings of the Enquiry into the Role and Impact of the IIS on Enterprise Development**

### **5.1 Introduction**

This chapter presents the main findings of the enquiry into the role and impact of the IIS on enterprise development with particular emphasis on SMEs. Following the strategy and methods set out in chapter four, the findings were drawn from the following major sources:

- macro data on 4246 IIS supported projects collected and collated from the EIA and regional investment offices,
- evidence from six cases of SMEs,
- over two dozen interviews conducted with authoritative individuals on enterprise development within and outside government (altogether representing 10 agencies),
- quantitative data from 9 agencies that were involved in the enterprise development such as the Land Lease Office.

These sources, as stated before, generated diverse qualitative and quantitative data that showed how and when events like enterprise start-up took place.

Moreover, they provide data that describe and interpret events in such a way that each confirms and/or challenges conclusions emerging from the others.

In section 5.2 I present macro statistics that show the dynamics of IIS assisted activities for the period 1992-98. These statistics suggested an emerging pattern of location of enterprises in Ethiopia. The findings presented in sections 5.3 and 5.4 were largely based on qualitative data and interpreted the macro statistics set out in section 5.2. Specifically, section 5.4 presents profiles of the case SMEs and entrepreneurs and whether their behaviour had been affected by IIS benefits.

Contrasting evidence and explanations to those that emerged in section 5.2, on the recent location patterns of enterprise start-up in Ethiopia are presented in section



5.5. The evidence presented in Section 5.5 shows the strength of the IIS as a mediating instrument in providing assisted enterprises with access to enterprise start-up resources, notably serviced enterprise sites. Section 5.6 summarises the main findings of the study<sup>47</sup>.

## 5.2 The dynamics and cost of IIS Assisted Enterprises: the macro picture

The data presented in this section show temporal, spatial and sector trends of IIS assisted activities. The data are organised by status of a project as completed, under implementation and 'inert' projects (that is projects which were never implemented). Finally, summaries of data based on totals and averages are presented and discussed. As a crude measure of IIS efficiency, the ratio of all IIS licensed and started up enterprises to the total IIS licensed enterprises is also reported.

### 5.2.1 Temporal dynamics of IIS Assisted Enterprises

At the national level the number of licensed projects for investment incentives increased from 542 in 1992/93 to 821 in 1997/98, and over the period 1992-98 a total of 4246 indigenous entrepreneurs were licensed (Table 5.1). However, a closer look at cumulative figures for 1992-98 shows that:

- (i) of the total IIS licensed projects only 1163 (that is 27 per cent) were successfully set up (Table 5.1, last column),
- (ii) enterprise start up rates were low in 1992/93 and 1993/94 (four and 15 per cent, respectively) but these rates jumped to 30 or more per cent over 1994-98 (Table 5.1 last row),
- (iii) the aggregate size of capital invested in the successfully set up projects was only 20 per cent of the plan. Consequently, the 1992-98 *birr* 6.7 million average size of IIS licensed projects dropped to *birr* 4.8 million as enterprises started up (Table 5.1, last column).

---

<sup>47</sup> Note that owing to the huge amount of information collected and summarised, in most cases the direct voices of interviewees are reserved for the subsequent discussion chapters.

**Table 5.1** The dynamics of licensing for investment incentives and actual enterprise start ups, 1992-1998 (enterprises size in mil. *Birr* and number, and ratios in per cent)<sup>48</sup>

Enterprises	92/93	93/94	94/95	95/96	96/97	97/98	1992-1998
IIS licensed:							
number	542	528	696	897	762	821	4246
capital	3750	3192	4731	6062	4541	6006	28282
size ratio (capital/project)	6.9	6.0	6.8	6.8	5.9	7.3	6.7
actual start-ups:							
number	23	79	233	310	237	281	1163
capital	57	500	1718	812	1278	1197	5562
size ratio (capital/project)	2.5	6.3	7.3	2.6	5.4	5.0	4.8
New start up/IIS licensed (in per cent):							
number	4	15	33	35	31	34	27
capital	1.5	16	36	14	28	20	20

*Source: EIA unpublished data and own calculation.*

The explanations for the above observations are strongly interrelated and are set out below.

First, the discrepancy between IIS licensed projects and enterprise start ups: Of the total 4246 licensed projects over 1992-98, 27, 16 and 57 per cent respectively were successful start ups, projects under implementation and projects that have never been tried out (inert projects). Extensive interviews and discussions

---

<sup>48</sup> As EIA data were aggregated, the overall size structure of IIS licensed projects cannot be inferred from Table 5.1. However, based on IIS licensed project files at EIA that had complete information on investment capital, data set was compiled on 377 projects (out of 4246). This data set showed that 64 per cent of IIS licensed projects were proposed with or less than *birr* half a million, and 20 per cent with more than *birr* 5 million. I refer to this finding as an important point because, as chapter six will show, it suggested that the size of projects initiated at less than *birr* half a million start-up capital (close to the IIS entry criterion) was in part influenced by the IIS incentives.



conducted with informed officials explain why so many licensed projects failed to convert into successful start ups:

- (i) in the early 1990s licensing was not based on carefully planned projects. As the investment code was passed in 1992, subsequent to the fall of the Derg regime, the euphoria among entrepreneurs and the EIA meant that some of the licensed projects did not undergo rigorous project appraisal procedures, and the viability of these projects was not checked.
- (ii) problems of access to and cost of enterprise sites: following experience from the Derg era, prior to the land lease holding system investment applications were made on the expectation that enterprise sites would be obtained free of charge (or applicants wanted to stay in the queue for land allocation). It took about two years to enact the land lease policy - by the time the policy was enacted in 1993 many entrepreneurs were already discouraged from doing business. Secondly, many project plans in 1992-93 did not include land prices. With the introduction of the land lease policy, enterprise sites became expensive. Consequently, many investment licence holders failed to raise the money to pay for the lease price of land.
- (iii) problems of access to bank loans: some projects were prepared on the assumption that bank credit would finance capital costs like machines and equipment. However, as subsequent sections will show, tough collateral conditions of the banks meant that many licence holders had to abandon the idea of setting up an enterprise.
- (iv) entrepreneurs, especially Ethiopians who returned from abroad, did not predict what might be awaiting them by way of bureaucracy and infrastructure. Entrepreneurs faced cumbersome bureaucracy in conducting start up processes ranging from simple business registration to resource mobilisation which subsequently led them to abandon plans.
- (v) low business confidence: a constellation of factors including the fragile nature of peace and stability in parts of Ethiopia and policy uncertainty, especially over access to land, discouraged enterprise start up.

Second, the rate of enterprise start up, however, improved over time: Relative to 1992/93 and 1993/94 over 1994-98 start up rates improved. This was largely due to two things. (i) some of the conditions that discouraged enterprise start up (i.e.



those stated above) improved. For example, the land lease policy enacted in 1993, although expensive, did give entrepreneurs the opportunity to lease land.

Moreover, peace and stability in the country had hugely improved since 1993/94.

(ii) interviewees also said that in recent years entrepreneurs became more aware of the benefits of preparing and submitting more viable projects for IIS support. These improvements enabled a higher proportion (34 per cent in 1997/8) of entrepreneurs to implement their projects.

Third, the reasons as to why enterprises at start up exhibited lower levels of capital and employment than at plan/project approval stage: Table 5.2 summarises these reasons which spread over successive stages of enterprise start up. First, in the pre-IIS licensing stage entrepreneurs have different incentives and tendencies to inflate project costs (Fikre, 1998). For some entrepreneurs who propose larger projects the incentives were non-IIS benefits like easy and cheaper access to resources like enterprise sites, and simplified facilities (such as through one stop shops provided by the authorities like the EIA. For some entrepreneurs proposing smaller projects the incentive for over-estimation of costs was to do with meeting the entry criterion for the IIS, that is the *birr* 250 000 minimum capital requirement. Finally, employment records particularly at pre-licensing stage, included inflated seasonal labour. EIA data shows that only 18 percent of all jobs created were permanent<sup>49</sup>.

---

<sup>49</sup> EIA unpublished data (1998) showed planned and actual jobs created in IIS licensed activities. Accordingly, over the period 1992-98 the 4246 IIS licensed projects were expected to generate 598390 jobs, or 141 per project. However, 1163 projects that started up created a total of 266284 jobs showing an increase in the average employment size per new enterprises to 279. However, these figures were dubious. In seasonally affected activities like coffee hulling, construction and farming a large proportion of the jobs were temporary. The statistics referred to showed that only 18 percent of all jobs created were permanent (that meant about 50 permanent employees per enterprise).

**Table 5.2 Explanations for the difference between investment and employment sizes from pre-licensing to start-up**

Pre-licensing for investment incentives	Sizes at project review stage (EIA)	Sizes during preparation for start	Sizes during start up and after
<ul style="list-style-type: none"> <li>- project costs inflated to get access to non-IIS benefits</li> <li>- IIS entry rule encourages over-estimation of project costs</li> <li>- employment record includes seasonal labour</li> </ul>	<ul style="list-style-type: none"> <li>- loose licensing criteria</li> <li>- staff limited ability to assess project feasibility</li> </ul>	<ul style="list-style-type: none"> <li>- tough loan collateral conditions</li> <li>- purchase of machinery in stages/need for learning production &amp; organisation methods</li> <li>- difficulty in and cost of leasing land or buying premises and access to services like utilities</li> <li>- limited entrepreneurial ability and lack of institutional support in importing machinery</li> <li>- policy uncertainty</li> </ul>	<ul style="list-style-type: none"> <li>- need to learn project implementation and production process</li> <li>- tendency to start side business</li> <li>- loss of income tax exemption privileges</li> </ul>

*Source: own construction*

Second, as projects were reviewed and accepted for licensing investment and employment sizes hardly changed. This was attributed to (a) the IIS guidelines that were weak in ensuring the quality of projects submitted for support (projects received an IIS incense by virtue of meeting the size and industry rules). (b) even when attempts were made to improve on the quality of projects submitted, staff at EIA and regional investment offices lacked the capacity and skills to fully assess projects submitted for licensing (Sileshi, 1998).

Third, as entrepreneurs prepare to implement projects their expectation of and ability to raise the necessary finance for buying premises, enterprise site and



import machines fell because of tough collateral requirements for bank loans. Moreover, as evidence from the case studies will show, as some projects officially started project plans were only partly implemented. This was due to lack of experience in selecting, importing and installing the full range of machines and equipment at start up, perhaps a factor that accounted for a large part of the gap between sizes at start up and plan stages. Some enterprises also lost their income tax exemption privileges as they did not make a profit shortly after start up.

### 5.2.2 Spatial and sector patterns of IIS Assisted Enterprises

As discussed in chapter three, the traditional location pattern of Ethiopian enterprises has been dominated by Addis Ababa and the Addis Ababa-Nazareth corridor. However, the 1992-98 data on IIS licensed projects showed what appeared to be a shift in this traditional pattern of enterprise location (Table 5.3). From Table 5.3 some key observations emerge:

- (i) the share of Addis Ababa in the total IIS licensed projects was 65 per cent (the highest in the country) in 1993/94 but declined to 31 and 39 per cent in 1997/98 and over 1992-98, respectively. In terms of IIS assisted actual enterprise start ups Addis Ababa's share was as high as 44 per cent in 1993/94 but dropped to 17 and 16 per cent in 1997/98 and 1992-98.
- (ii) in spite of the fact that the IIS was meant to assist a large part of the country collectively labeled as 'other' regions, enterprise start-up rates in these regions were below 5 per cent of the total over 1992-98.
- (iii) the common feature in both Addis Ababa and the 'other' regions was that converting IIS licensed projects into actual enterprise start ups was lower than the rest of Ethiopia.
- (iv) in contrast to Addis Ababa and 'other' regions, regions such as Tigray and SENNPR showed better implementation of IIS licensed projects.



**Table 5.3 Regional dynamics of project licensing for the IIS (enterprise number and capital in mil. birr)**

Region	1993/94		1997/98		1992/98	
	TL	OE(ER)	TL	OE(ER)	TL	OE(ER)
Addis Ababa						
enterprise no.	342	35 (10)	254	47 (19)	1677	193 (12)
capital	2019	141 (7)	3164	397 (13)	13026	1208 (9)
Amhara						
enterprise no.	29	12 (41)	53	29 (55)	362	109 (30)
capital	166	65 (39)	187	142 (76)	1264	401 (32)
Oromia						
enterprise no.	99	19 (19)	170	48 (28)	937	329 (35)
capital	271	50 (18)	794	97 (12)	4210	1165 (28)
SENNRP						
enterprise no.	15	4 (27)	182	128 (70)	484	226 (47)
capital	242	12 (5)	501	345 (69)	1551	675 (44)
Tigray						
enterprise no.	25	7 (28)	23	12 (52)	380	256 (67)
capital	255	210 (82)	154	185 (120)	3354	1869 (56)
Other regions						
enterprise no.	18	2 (11)	139	17 (12)	406	50 (12)
capital	239	22 (9)	1206	31 (3)	4877	244 (5)
Ethiopia						
enterprise no.	528	79 (15)	821	281 (34)	4246	1163 (27)
capital	3192	500 (16)	6006	1197 (20)	28282	5562 (20)

*Source: EIA unpublished data and own calculation. TL= total licensed, OE = operating enterprises, and ER = efficiency rate (OE/TL) in per cent.*

The key questions that follow these observations are: why in both Addis Ababa and 'other' regions was implementing licensed projects such a problem? Why, in the first place, if Addis Ababa and the corridor were already preferred for investment (particularly manufacturing investment) and the IIS was to have affected the location of industry moving it outside this zone, did the EIA award

the largest number of licences to the Addis region? What were the factors that led to this and what alternatives did the authorities have? These questions are explored in turn below.

**First, project licensing and enterprise start up in Addis Ababa and the Addis Ababa-Nazareth corridor:** Addis Ababa (and the corridor) have always attracted new enterprises in the manufacturing and services sectors for two basic reasons. First, they have always enjoyed better infrastructure, business agglomeration and market over the rest of the country. They have the Addis Ababa-Djibouti railway, and the highway that connects ports in east and Kenya in the south. The two high density industrial clusters of Ethiopia, Akaki and Kaliti, are also located along the Addis Ababa-Nazareth corridor. Consequently economic expansion and physical growth of Addis Ababa has been along the south east, that is the Addis Ababa-Nazareth corridor. Second, in particular over 1992-94, when most parts of Ethiopia lacked peace and stability to conduct business, Addis and the corridor had relative peace that enabled them to start enterprises and conduct business. As evidenced in Table 5.3, both these factors led to a higher expression of intent to set up enterprises in Addis Ababa over 1992-98. Accordingly entrepreneurs that chose to set up manufacturing and service sector enterprises in Addis Ababa accounted for 46.5 and 60 per cent of the total IIS licensed 1848 and 1237 projects respectively.

The answer to the question why the authorities granted licences in Addis very much depends on the conditions for obtaining an IIS licence and the benefits that the licence accrues to the entrepreneurs. According to the IIS rules all entrepreneurs need to meet the industry entry criterion to get exemption from the payment of duties on imported capital goods. Then in addition to the industry criterion, all entrepreneurs need to meet the location criterion that enables them to receive additional incentives that vary according to the chosen locations (in the



least developed areas the period of exemption from the payment of income tax is the longest - that is five years, whereas in Addis Ababa and the corridor this period is only one year). As section 5.2.3 will show, the benefits from income tax exemptions are smaller than the benefits from exemptions from the payment of duties. Moreover, exemptions from income tax depend on entrepreneurs making profits within the grace period.

Many entrepreneurs too were more interested in an IIS licence that gave them entitlement with exemptions from the payment of duties on imported capital goods - a benefit not linked with the location criterion. Hence because of better location advantages (perhaps that exceeded benefits from exemption from income taxes) many entrepreneurs proposed projects in the 'pioneer' sectors in the Addis and the corridor (Table 5.3). The authorities, therefore, had no legal ground to deny entrepreneurs an IIS licence with all its entitlement within Addis Ababa and the corridor. Moreover, licensing projects for an IIS in Addis and the corridor was consistent with the IIS objectives of increasing investment, employment and technology transfer. If anything the problem with the IIS authorities was their attempting to influence the regional pattern of enterprise development with an inefficient IIS instrument. While the IIS rules led the authorities to grant a large number of applicants from the Addis Ababa and the corridor, however, they did not come up with alternative intervention instruments such as developing basic social and physical infrastructure and entrepreneurship to encourage enterprise development in less developed areas<sup>50</sup>.

---

50 In spite of the fact that there was a large number of IIS granted projects in Addis Ababa and the corridor, enterprise start up in the zone has been constrained by the exorbitant land lease price. The lease price in Addis Ababa was as high as *birr* 4300/m<sup>2</sup> while this dropped in smaller towns outside Addis Ababa and the corridor as low as *birr* 5/m<sup>2</sup> (Tahir Aman, 1998). Note that only 30 and 28 per cent of the total start ups (497 and 152) in the manufacturing and service sectors, respectively, were implemented in Addis Ababa.



**Least developed regions<sup>51</sup>:** In the least developed regions (referred to 'other' regions in Table 5.3) IIS licensing increased from 18 in 1993/94 to 139 in 1997/98. However, of the total licensed projects 93 (67%) and 21 (30%) were in two large urban centres, Dire Dawa and Harar, respectively. In terms of planned capital investment Dire Dawa alone had 91 per cent of proposed investment. Actual start ups in Dire Dawa were only 2 in 1993/94 and 17 in 1997/98. This was because, like Addis Ababa, in large urban centres access to and cost of land were major problems to enterprise start up. In the sparsely populated less developed areas, in spite of being offered the best IIS assistance, there were only a few start ups because these regions had poor infrastructure and market. Most of all because the less developed regions were sparsely populated and home to nomadic people they had inadequate number and quality of local entrepreneurs to take advantage of the IIS support.

**Intermediate regions:** Regions that gained from the spatial distribution of enterprises were those in the middle like SENNPR and Tigray. Better enterprise start-up in these regions was because, contrary to the 1970s and 1980s, for most parts of the 1990s these regions were free of civil war and enjoyed better political stability. Regional government officials in Tigray and SENNPR also provided entrepreneurs with easier access to enterprise sites (Hammond, 1994). As a consequence of the sum of such positive developments the two regions in particular performed well above the national average of enterprise start-up rate.

**Finally, did the IIS switch enterprise start-up away from the centre?** I acknowledge Addis Ababa's relative loss of position but I contest the suggestion that the IIS was a factor in switching entrepreneurial location decisions specially away from Addis Ababa. To advance my argument (see also chapter 6) I use (i)

---

<sup>51</sup> These include four of the 11 regional units of the country: Afar, Benishangul and Gumz, Gambela and Ethiopian Somali Region, and the cities of Dire Dawa and Harar.

data on IIS 'assisted' enterprise start ups (in addition to IIS licensed projects) as the basis of the discussion on enterprise location patterns especially over Addis Ababa versus the rest of Ethiopia. (ii) along with the 1992-98 IIS 'assisted' enterprise start up patterns I use data that show the historical spatial pattern of enterprise developments. And (iii) I propose to focus the discussion on activities that Addis Ababa and the other regions have in common. Item (iii) is important because the Addis Ababa region (as a city) cannot be compared with other regions on the basis of activities like mining and plantations. The better indicators would be the services and manufacturing sectors that most regions, with varying degree, seem to have. Because the IIS gives more emphasis to the manufacturing sector than services, the evidence produced here focuses on the manufacturing sector enterprises of small-large sizes (as shown in Table 5.4). In Table 5.4, columns 2 and 3 refer to cumulative data on small to large enterprises of Ethiopia. Columns 4 and 5 refer to the 1992-98 IIS licensed projects and actual start up in the manufacturing sector. Column six adds up columns 2, 3, and 5 and shows the total of small to large manufacturing enterprises in the country.



**Table 5.4** Changes in the spatial patterns of manufacturing enterprises: traditional vs IIS-assisted start up patterns<sup>52</sup>

Region	small manuf'ing enterprises (CSA, 1997e)	medium & large manuf'ing enterprises (CSA, 1997b)	1992-98 IIS licensed projects, secondary sector	1992-98 IIS 'assisted' start up, secondary sector	Total (column 2+3+5)
Addis Ababa	43.0	68.2	46.5	29.6	45.4
Amhara	14.1	6.2	5.9	3.8	11.5
Oromia	22.9	11.1	21.0	22.5	20.9
SENNRP	7.9	5.4	15.5	32.3	10.7
Tigray	5.7	3.3	5.1	8.6	5.6
Other regions	6.4	5.8	6.0	2.6	5.8
Total	100=2731	100=642	100=1845	100=497	100=3870

*Source: EIA (1998) unpublished data, CSA 1997b and 1997e and own calculation.*

Table 5.4 show that, first, for all sizes of enterprises, whether IIS assisted or not, there was a skewed distribution of manufacturing enterprises in favour of Addis Ababa and this persisted until the present time. Addis Ababa (and major urban centres like Nazareth) always attracted relatively larger enterprise. In spite of being least assisted through the IIS, Addis Ababa however continued to attract manufacturing enterprises. An exception to this evidence is the SENNRP where 160 or more small enterprises started up largely without drawing on IIS benefits (see section 5.2.3 below). Second and more importantly, in spite of being classified as 'most assisted' through the IIS, the least developed 'other' regions did not gain a share in the national distribution of manufacturing enterprises. Regions like

---

<sup>52</sup> CSA 1997b and 1997e are cumulative data on (i) medium and large enterprises, and (ii) small enterprises, respectively. Medium and large enterprises are often reported together hence there were no separate data on SMEs. Of the total medium and large enterprises 169 were public and 473 private enterprises. EIA data for the 'secondary sector' refer to manufacturing consumer goods, metals, pharmaceuticals, etc. IIS-assisted start up are those projects that had an IIS licence but were not necessarily assisted through the IIS, as a good number of them did not receive the support. There was a possibility of double counting as IIS assisted start ups from the early 1990s may have been counted in the CSA 1997b and 1997e data.



Benishangul and Gumuz had no any size of manufacturing enterprises either in the CSA data or the recent IIS-assisted start ups. In short, therefore, the IIS did not explain the spatial distribution of manufacturing enterprises.

To summarise, the discussion in this section showed that Addis Ababa (with or without the IIS support) still dominates in the spatial pattern of enterprise development in Ethiopia. However, the IIS does not necessarily support a more radical investment in new industries. Meanwhile some regions have done better but this is not necessarily to do with the IIS. The regions that have not been doing better in enterprise start ups are not getting the support they need. Overall, therefore, the IIS is not properly integrated into a holistic package of policies - industrial, SME and regional.

### 5.2.3 Cost of providing the IIS

**Sources and size of revenue foregone:** At EIA, for the first time, I initiated and took part in the collection and collating of new data on revenue foregone due to the IIS. Accordingly, I found that with the view to promoting enterprise start-up through the IIS over 1992-98 a total of *birr* 526 million government revenue from import related taxes has been foregone. Of the total revenue foregone import duties accounted for 48 per cent, and import related sales and excise taxes, respectively, accounted for 51 and 1 per cent. In terms of use activities described as services and manufacturing received 42 and 50 per cent respectively. Primary activities that were supported by the IIS benefited only about 8 per cent of the revenue foregone. Such a low benefit in the primary sector was in part owing to delays in the rural land lease policy and the precarious peace situation in the countryside in the early 1990s.

Based on evidence from the Customs Authority and EIA, I found that the most common import duty and sales taxes were 5 and 10 per cent, respectively. These taxes together provided individual IIS entrepreneurs with about 13 per cent of the

value of imported capital goods. However, as the tax rates applicable to some small tools and implements were relatively higher than heavy machines it is possible that entrepreneurs that imported small implements with the IIS assistance may have saved more that 13 per cent of the value of the imported goods (see details in Box 5.1).

**Box 5.1      Tax rates and method of calculating revenue foregone to the IIS**

(i) tariff and income tax rates		
The IIS benefit to the entrepreneurs come from exemptions from import duties and income taxes. The level of tax rates play a significant role in determining the level of these benefits. According to Proc. No. 36/1996 (PDRE, 1996c), income tax from business was 35 per cent. But to the best of my knowledge up until the end of 1998, there were no data that showed revenue foregone from income tax exemption. As it will be argued later in the thesis, entrepreneurs' benefit from exemptions from income taxes, relative to import duties, was very limited. Hence, the evidence below focused on exemptions from import duties including sundry taxes like sales and excise taxes.		
Some Representative Tariff Items and Duty Rates (1993-97)		
tariff item	duty rate	duty
rate	1993	1996
(1997)		
Tools and implements (of which):		
- hand saws and hand saw blades	30	30
- spades and shovels	30	20 (1997)
Construction and agricultural machinery (of which):		
- graders, levellers, road rollers	5	5
- agricultural mach.	5	5
(seeders, combine harvesters-threshers)		
Machine-tools (of which):		
- for working metal (thread rolling, tubes)	5	5
- for working wood (sawing, milling, sanding, drilling, splitting, slicing, paring)	5	5
Machine tools for making or repairing footwear	5	5
Sewing machines	10	5 (1997)



Motor Vehicles (of which):		
- goods transport	10	10
- special purpose (eg crane lorries, concrete-mixer lorries, mobile drilling derricks)	20	5 (1996)
Source: Customs Authority/MoF (1993, 1996 and 1997).		
<p>Over 1992-93 the tariff structure of Ethiopia has been significantly reformed, for example, the maximum tariff rate has been cut from 230 per cent (ad valorem) to just 40 per cent (see details in Arega, 2000). Tariffs on heavy machines like agricultural, construction and goods transport were reduced to 5 per cent. However, tax rates applicable to small tools and implements were subject to duty rates as high as 30 per cent. In addition to duties all imports were subject to a uniformly 10 per cent (of value) sales tax and a varying excise tax.</p> <p>(ii) estimating revenue foregone: With the help of two statisticians from the EIA (and their counterparts at the customs office) government revenue from import duties and sundry taxes amounting <i>birr</i> 420.6 million was collated. These collated data came from Addis Ababa (Laghar and Bole Airport) and the port of Mitsiwa before the Ethio-Eritrean conflict. We estimated that these locations put together cleared 80 per cent of imports, and by implication 80 per cent of the revenue foregone. Further, with total agreement with the experts involved, we estimated that the 100 per cent revenue foregone would amount to <i>birr</i> 526 million. However, one has to be wary of these estimates as, for example, entrepreneurs were exempted from income tax and this has not been included in the estimation.</p>		

What was more interesting was the fact that 93 per cent of the foregone revenue concentrated in Addis Ababa (60 per cent) and Tigray (33 per cent). With only a 3 per cent share, the country's largest region Oromia trailed in third place (Table 5.5).



**Table 5.5      Regional distribution of revenue foregone from import duties and sundry taxes due to the IIS, 1992-98.**

Region	Revenue Foregone	percentage share in total
Addis Ababa	313.5	59.6
Amhara	8.4	1.6
Oromia	17.7	3.4
SENNPR	6.9	1.3
Tigray	172.5	32.8
Other regions	6.8	1.3
Ethiopia	526	100

*Source:      EIA unpublished data and own calculation.*

Earlier in Table 5.3 I noted that SENNPR region was among the best performers, but according to Table 5.5, SENNPR did not receive the best of the foregone revenue. Hence, the question was, what explained the spatial pattern of the use of revenue foregone, especially as it did not clearly follow IIS performance? I found that the major explanation for this discrepancy was that both Tigray and Addis Ababa produced the most capital intensive secondary and tertiary sector activities such as in manufacturing and hotels and appropriated most of the revenue foregone. This can clearly be seen from Table 5.3 where the national average of capital per new enterprise over 1992-98 was *birr* 4.78; an average project set up in Addis Ababa and Tigray, respectively, had *birr* 6.25 and 7.30 million. As briefly discussed above events such as cessation of the war, and better infrastructure also favoured these two regions in initiating relatively sizeable projects.

**Non-tax revenue costs of providing the IIS:** It was clear that, in addition to the cost of *birr* 526 million revenue foregone from import duties alone, the IIS involved other costs. First, the direct costs of IIS administration at the national, regional and zonal levels involved at least 500 staff at a cost to the tax payer. Second, as I will demonstrate in section 5.5, the IIS also resulted in some huge indirect costs associated with the provision of subsidised resources like enterprise

sites to some AEs. Third, although interview based evidence was patchy, the authorities noted incidences of IIS displacement effects. For example, in 1998 some old cooking oil processing enterprises were going out of business due to the increase in new enterprises that entered the market with IIS subsidized investment capital.

The foregoing section showed the spatial and sectoral patterns of IIS assisted enterprises start ups. But the macro statistics did not show how many IIS licensed projects actually drew on IIS benefits. The next section looks at the evidence on IIS incentives utilisation rate.

#### 5.2.4 IIS incentives utilisation rate

At a national level EIA data did not show IIS incentives utilisation rate, therefore, I used a smaller data set collected from the Oromia region (Table 5.6). I will argue that these data were significant because (i) they covered the period 1992- 97 and 761 licensed projects for the IIS. (ii) Oromia also covered the two extreme areas that the IIS supports - that was the central location of Addis Ababa-Nazareth corridor and remote areas like Borena. However, as Oromia's share in the total revenue foregone (Table 5.5) was only 3.4 percent of the total, any generalisation from these figures is likely to result in a possible over-estimation of the number of enterprises that benefited from IIS.

What emerged from the Oromia data was that most entrepreneurs who had an IIS licence and set up enterprises actually did not use IIS incentives. Referring to Table 5.6, over 1992-97 Oromia produced 761 projects that were licensed for IIS support. Of these projects 360 (47 per cent) were either completed and started operation or were under implementation. Of the 360 projects which were in the implementation phase and/or completed and commenced operation, only 131 (36.4 per cent) were effective beneficiaries (users) of the IIS support. Therefore, the key conclusion that emerged from these data was that as many as 64 per cent of



IIS licensed entrepreneurs actually set up enterprises without drawing on the support.

**Table 5.6 Actual beneficiaries of the IIS support (1992-97)**

<b>IIS 'assisted' projects or enterprise start ups</b>	<b>Totals (per cent)</b>
total IIS licensed projects (TL)	761 (100)
projects completed (OE) and/or under implementations (UI)	360 (47)
Effective IIS users	131 (17)
Effective IIS users/TL	17.2 per cent
Effective users /OE+UI	36.4 percent

*Source: Oromia Investment Office (1997), and own calculation.  
(OE = complete/operational project, UI = project under implementation, and TL = total licensed projects.)*

To sum up, data presented in this section showed that over 1992-98 licensing for the IIS has been steady but only a few enterprises were set up. Moreover, about 64 per cent of the enterprises that were IIS licensed and set up did not benefit from the support. Most of the IIS benefit (foregone revenue) also went to enterprises that were set up in Addis Ababa, a region least supported by the IIS and which produced relatively fewer successfully set up enterprises.

Based on views from government and professional agencies, section 5.3 below interprets the evidence presented above.

### **5.3 Rationale for supporting SMEs: views from government and professional agencies on enterprise development**

Over a dozen well informed officials in Ethiopia's enterprise policy and development were engaged to discuss the most important start-up and growth problems of SMEs, and the relevant public support that these units were receiving. Moreover, the interviewees were asked to identify and discuss the role and impact of the IIS. Most of these interviewees came from the EIA and OIO, the Addis Ababa Association of Private Industries (API), and the then Ministry of



Economic Development and Cooperation (MEDAC). Results of the discussions are summarised below.

### 5.3.1 SME start-up and growth problems

The discussions uncovered the following SME problems:

- historically the private sector has been constrained - in the 1970s and 1980s, due to ideological reasons, privately owned enterprises have been marginalised.
- national structural problems - poor physical infrastructure (like power, roads and telephone lines, and water supply) was hampering enterprise development.
- institutional structures (business information system, promotional services, consultancy and advocacy agencies, institutions for developing technical and managerial skills, banking, etc.) were inadequate.
- adjustment reform policies (for example, energy reform, devaluation, and interest rates) were adversely affecting business by increasing the costs of machines and raw materials.
- the tax system was prohibitive, for example, corporate income tax was as high as 35 per cent, and manufacturers who used imported raw materials were paying double sales taxes at the point of entry and final sale at the factory gate.
- high cost of and difficult access to land and premises have made the pace of enterprise start-up and growth slow.
- enterprise start-ups confronted a cumbersome bureaucracy of registration and licensing (for operation, import and export) - especially for those involved in professional businesses as in the health sector, and those operating in more than one region.
- chronic structural problems of entrepreneurs and enterprises themselves - traditionally entrepreneurs were culturally stigmatised; most entrepreneurs were less educated and used limited information in developing business ideas; many entrepreneurs tended to imitate the ideas of others; enterprises were low resource based and external financing was limited by bank collateral conditions; dire shortage of skilled technical and managerial

personnel who can run businesses; shortages of markets for products; inability to maintain product quality; haste to take enterprise to maturity and tendency to open side businesses before achieving success in the first attempt.

In spite of these multitudes of problems faced by the enterprise economy, the interviewees identified only a few programmes, including the investment incentives scheme (IIS), and skills training through the development agency for handicrafts and small scale industries (DAHSI) (these enterprise support initiatives have been comprehensively discussed in chapter three). However, the respondents agreed on the need for providing more support for the development of enterprises. In broad terms, the interviewees advanced two lines of arguments:

- first, providing neutral (non-discretionary) enterprise support - such as providing information, skills development, better enabling environment (notably more reform in the tax system), cut the bureaucratic hurdles in business licensing; and better social and physical infrastructure.
- second, selective interventions like offering differentiated bank credit rates, generous support for the export sector, setting up schemes like enterprise zones and business incubators.

Interviewees also made suggestions that included the set up of an independent government department to advise entrepreneurs on business idea development, and involve entrepreneurs in the policy making process. Some respondents went further and argued for a fundamental cultural change that goes through the entire education system and encourages entrepreneurship.

IIS licensing procedures and costs were some of the factors that entrepreneurs considered prior to seeking investment incentives. Hence before I consider the IIS impacts on enterprise start-up in section 5.3.3, in section 5.3.2 I will describe IIS structure and procedures for granting an IIS licence.



### 5.3.2 Institutional framework for delivering the IIS

The IIS was a nationwide scheme with structures laid down at the federal, regional and zonal administration levels. The Ethiopian Investment Authority (EIA) was the federal nucleus for all matters of the IIS administration including overseeing foreign investment, and those activities which required federal level trade and operating licences. EIA (which also represents the Addis Ababa region) initiated relevant policies, issued investment permits and followed up investment projects. Regional (and zonal) investment offices performed corresponding administrative functions, not included in the EIA jurisdiction.

The key departments and units of the EIA and regional investment offices included the licensing, registration and coordination department (LRCD), the policy research and information department (PRID), the project evaluation and follow up department (PEFD) and the records office.

#### 5.3.2.1 Screening processes for granting IIS support

Entrepreneurs who sought an IIS licence first approached the EIA or, depending on the legal jurisdictions, the regional investment offices. On a first visit entrepreneurs were given two identical application forms (for *birr* 5 each) along with the necessary guidelines to complete the forms. The forms required a brief description of the proposed project, and information on the production/service capacity of the project, its fixed and working capital, staple raw materials and output, and market for outputs.

In addition entrepreneurs were required to provide a list of machines that were to be imported along with the price proformas. Entrepreneurs were also required (a) to provide design plans if a project was in the health and education sectors that required national standards. (b) incorporated bodies needed to provide copies of memoranda of understanding and articles of association on the formation of their company (or in the case of a foreign company, legal existence of the company and



minutes on the decisions for setting up in Ethiopia). (c) for Ethiopian companies summary registration from relevant departments, if already done, had to be produced. (d) other requirements included passports and residence permits for non-Ethiopians. I noted that those entrepreneurs who were less educated and/or less able to capture and make use of this information, needed support to understand and complete an IIS application form. Unfortunately there was only limited official institutional support in this area.

Duly completed forms were submitted to and recorded at EIA's Records Office. Subsequently, technical and legal aspects of the applications were simultaneously assessed by sub-units of the licensing, registration and coordination department (LRCD) and the project evaluation and follow-up department (PEFD). Technical aspects of the review dealt with a project's environmental impacts and whether the type of proposed activity (and its location) merited incentives as laid down in the regulations. The legal aspects of the assessment considered the status of the entrepreneur (or investor) in Ethiopia, the legal form of business association and requirements related to third party notifications of the business formation. Finally, following the satisfaction of the EIA staff on the foregoing basic criteria, entrepreneurs were granted investment licences, with specified privileges.

From the interviews I conducted with the authorities and EIA files referred to, entrepreneurs who met the basic sector or industry criterion of the IIS had a 100 per cent chance of obtaining the IIS licence. Overall, the licensing procedure leading up to and including the granting of the licence took ten to sixty days. Because of lesser legal requirements small or sole proprietor projects, like a flour mill, were granted licences within ten working days. However, many medium to large projects had difficulties in meeting the legal requirements in business registration. The Ministry of Justice, which had staff shortages, was performing business registration, and third party notification of articles of association was

done at the Ministry of Information. This third party notification in particular required the publication, in a national newspaper, of article of association. Such publications not only depended on clearance from the Ministry of Justice but also on whether the very few national newspapers had space for printing these notifications.

The number and technical capability of staff at EIA or Investment Offices also played a part in delaying the licensing procedure. Some projects (for example, in the chemical sector) required longer time and more information to work out their possible environmental consequences. With few staff and support services like computers, as an official admitted, delays were inevitable. Finally, other applicant-related problems, like failure to provide all the required information in good time, also delayed the licensing procedures.

#### 5.3.2.2 Following up project implementation

As my interview with three most relevant staff (two from EIA and one from Oromia investment office) showed, licensed projects were also monitored. Copies of all licensed projects were passed to the project evaluation and follow-up department (PEFD) for continuous follow-up and monitoring. PEFD's follow-up of projects was performed using such means as sending out standard forms, telephone calls, and field visits. The main objective of follow-up was to do with control: checking investment licence holders did not pass privileges to a third party, imported machines were deployed for the purposes of the project and the minimum capital requirement for support was fulfilled.

The interviews showed that IIS licence holders rarely broke regulations. However, there were a few incidences, for example, where generators and vehicles were used for purposes other than specified in IIS licence. There was also a case, from Debre Zeit, where the entrepreneur failed to install proper plant treatment for a tannery and as a result the environment was damaged. In these and similar



circumstances, PEFD took measures like making the offenders pay tax benefits back to the government, and/or closed down operations like the tannery in Debre Zeit. Regional investment offices also broke off land deeds with offending entrepreneurs.

With limited success, the PEFD follow-up exercise also monitored whether the IIS objectives (like jobs and social and environment impacts) were fulfilled. Project follow-up was carried out to support entrepreneurs in project implementation. Through the follow-up mechanism, project implementation problems were identified and advice was provided on sites, or other agencies (such as the land lease office) were approached to help entrepreneurs solve their start-up problems. Finally, according to the interviewees, the outcomes of the follow-up exercise were used to generate feedback for making changes to the IIS regulations.

Overall, the PEFD's follow-up reports and the interviews showed that there were gaps between the plan and implementation of IIS licensed projects, for example, there were so many inert projects (see below). Often, relative to plans, implemented projects were smaller in terms of capital and labour employment. The time for project implementation was also often overrun. The whole follow-up exercise also showed two weaknesses. First, most of PEFD functions (and the benefits) were focused on larger and often foreign-owned projects. Secondly, except for monitoring purposes, the PEFD did not evaluate the overall IIS impacts.

### 5.3.3 The rationales for and impacts of the IIS

**IIS roles and rationales:** Interviewees' reasons for SME support through the IIS included these units' ability to create more jobs, and address regional development inequality. The interviewees also provided the following rationales for the IIS:



- develop a sustainable economic base by moving investment into 'essential activities' like irrigation farms and engineering firms that require heavy investment and a long payback period.
- support the disadvantaged business environment outside Addis Ababa and Nazareth areas.

Overall, the IIS rationales that the interviewees provided formed three overlapping scenarios for enterprise support:

- sector dimension: pioneer/promoted over other activities;
- spatial dimension: peripheral over central regions, and
- enterprise size dimension: relatively larger over smaller enterprises.

These scenarios, however, did not necessarily follow consistent arguments. For example, the argument that favoured disadvantaged areas did not recognise the fact that small and micro enterprises were disadvantaged owing to lack of collateral to secure bank credit, lease land, or premises.

I found that the IIS avoided supporting relatively small enterprises (those with start-up capital less than *birr* 250 000) on the grounds that these enterprises were too numerous to provide support to and effectively administer the support.

Furthermore, it was argued that, smaller enterprises tended to cover their investment capital and become profitable quicker than larger enterprises.

Therefore, if small enterprises were excluded from the scheme, the argument ran, the adverse revenue impact due to the IIS would be minimised.

**IIS impacts:** Was the IIS working, and if so what was the evidence? First, the interviewees provided no evidence to support that the IIS influenced on entrepreneurs' choice of activity types. The authorities made it clear that they did not put pressure on entrepreneurs to change the type of their proposed activities. Therefore, what happened was that entrepreneurs who chose to enter to 'pioneer'

and/or 'promoted' activities did receive IIS incentives simply by the virtue of choosing those activities.

Second, regarding the IIS influence on entrepreneurs' choice of enterprise location, interviewees claimed that this had an impact:

- the fall in the share of Addis Ababa (relative to other regions) in the total IIS licensed projects from 65 per cent in 1993/94 to 31 per cent in 1997/98 (also see Table 5.2).
- that many new IIS supported enterprises were set up along the Sululta and Burayou roads as opposed to the traditional Addis Ababa-Nazareth corridor.
- that in 1997-98 alone some 60 new projects moved out of Addis Ababa in favour of the surrounding Oromia region.

I consider the strength of this evidence against the competing evidence and explanation in section 5.5. In section 5.5 I will also argue that the key factor behind recent changes in location patterns was mainly to do with the land lease policy, especially as it was applied in Addis Ababa.

To sum up, based on the perspectives of enterprise policy makers who took part in this study, section 5.3 showed that entrepreneurs were facing major constraints like access to enterprise sites, bank credit and inadequate infrastructure. However, policy makers responded to these constraints by offering entrepreneurs IIS incentives, which according to them impacted only in terms of influencing the location pattern of enterprises. But what did the entrepreneurs make of the IIS incentives? In section 5.4 I explore the enterprise level impacts of the IIS.

#### **5.4 The Investment Incentives Scheme and enterprise start up and growth: evidence from selected cases of SMEs**

The evidence in this section was drawn from the six case study SMEs. Below, first, the entrepreneurs and their enterprises are introduced (section 5.4.1). Then section



5.4.2 summarises a rather large volume of data organised around themes like motives for enterprise start-up and roles and impacts of the IIS<sup>53</sup>.

#### 5.4.1 Entrepreneur and enterprise profiles

**AE1 Shoe Factory:** Located at the heart of Merkato, the largest business centre in the country, AE1's staple product was leather shoes of all ranges. The product was supplied to retailers in Addis Ababa, two of which were shops owned by the family of Begashaw who owns AE1 (Begashaw, 1998). A barely educated man, Begashaw was 46 when he found AE1 in 1992. Begashaw, however, came from a family that had a successful hotel and a hardware shop. He also had experience in selling shoes since 1982.

The idea of setting up AE1 was initiated in 1990 following two developments: first, two of Begashaw's sons completed their pre-university studies but did not get a place at the university. Begashaw recalled that at the time 'except for the army job prospects for the youths were dismally low'. Second, the public policy environment changed and a mixed economy policy was declared which allowed individuals to own and run more than one business.

At start-up, to overcome his (and his sons') inadequate skills in shoe production Begashaw needed an experienced partner in shoe making. But Begashaw knew little about the IIS and proposed a project with only *birr* 50 000. He said that he 'was not aware of the minimum amount of investment [*birr* 250 000] required to obtain investment incentives'. He then, among other sources, borrowed *birr* 120 000 from the bank by putting up his house as a collateral. The additional money raised increased the size of investment in the project plan. Subsequently, the revised plan was granted an IIS licence that enabled the enterprise to import its major machines (sewing, skiving and stitching) without the payment of duties.

---

<sup>53</sup> For simplicity, entrepreneurs and enterprises are sometimes referred to as AE<sub>1</sub>, UE<sub>1</sub>, etc.



However, Begashaw did not take the opportunity of exemption from paying income tax, as he explained, because he was not able to keep records for tax purposes as required by the law.

In 1998 the overall operations of the factory were very low. Owing to lack of demand, the factory was operating only up to 3 out of 6 working days per week for months. Patchy records also showed that the factory produced no more than 4-5 dozens of pair of shoes a day. Further, the factory had no short to medium term investment plan. In terms of employment measures, however, AE1 grew from 8 in 1992 to 20 in 1998.

**UE1 Shoe Factory:** Kadir founded his leather shoe producing factory (UE1) in 1992 at the age of 31 (Kadir, 1998). UE1 was located in *Woreda* 14, commonly known as Arat Killo area. Apart from finding limited working space in 1992 and the founder's familiarity with the area, UE1's location was not particularly favourable for business as it was largely occupied by government office blocks. However, Kadir had opened two outlet shops in other parts of Addis Ababa.

As a young man Kadir came to Addis Ababa from rural Ethiopia. In Addis Ababa he was first an apprentice, then upon obtaining skills in shoe making he set up a shoe repair shop that was not legally registered. Consequently the Addis Ababa city administration deemed the business illegitimate and the shop was demolished. Kadir managed to rent a small house and soon started operating again but this time in the informal sector. As Kadir's underground business (including small scale shoe production) thrived he invited two of his younger brothers to join him in the business as well as supporting their studies in Addis Ababa. Kadir explicitly said that his 'desire to be independent and provide work for relations' were the motives for starting up and running the business.

According to Kadir, change in government and policy in 1991 was the major factor for UE1 to have evolved and become a legally registered business in 1992.

Kadir thought, only to be proved wrong, that the new policy would let him operate freely and provide him access to land and working premises. However, one may argue that the growing scale of UE1's informal operation could have played a part in UE1's founder leaving the informal sector.

Similar to AE1, UE1 was eligible for IIS incentives. However, Kadir did not seek IIS incentives for reasons that included his own distrust of politicians and bureaucrats and inadequate knowledge of the IIS. At start-up UE1 production tools and machines were purchased from local suppliers. Relative to AE1, most of UE1's tools (except for a couple of sewing machines) were either mechanical or semi-electrically operated. This, among other things, suggested that enterprises like UE1 that used simple and locally available capital goods, in addition to paying taxes, have saved on energy.

At start up in 1992 UE1 employed 6 workers and in 1998 the workforce increased to 17. But, similar to AE1 above, in 1998 UE1 operated way below full capacity level, that was 4 out of 6 working days per week. Owing to difficulties in obtaining an industrial site, UE1 had no investment plans in sight (although the owner was contemplating opening up a textile trading house that only required a small floor space to run).

**AE2 Engineering Enterprise:** AE2 was a medium size engineering enterprise that commenced production in 1994. The enterprise had in-house capacity to design, build and erect industrial, commercial and residential structures in steel. Its main expertise was in making fuel depot canopies, over and underground tanks, roof and wall systems. The enterprise also produced and supplied corrugated iron sheet directly to the market. Owing to the economic significance of these activities of AE2, the IIS treated it favourably and, in addition to import duty exemptions, it was granted three years of exemption from paying income tax (Asegid, 1998).



AE2, located in *Woreda* 19 of Addis Ababa, was found by a husband and wife. The manager Germa, who was 42 in 1994, was a civil engineer by training and he had the experience of working for the government in Ethiopia and in the UK and USA. The choice of this engineering firm was initiated by the prospect of good profits that depended on a 'huge market' for products like corrugated iron sheet. To achieve their objective, AE2 founders built modern plant and office premises (on 1800 m<sup>2</sup> government granted industrial site) and employed qualified staff. They attracted an experienced and qualified workforce mainly from those known to them in the government sector. One such significant addition was the acting manager who had a BSc degree in civil engineering and an MBA from Birmingham University, UK. The founders were also risk conscious as they sought IIS incentives to minimise the risk of losing a business that required huge investment and working capital (AE2's capital, mostly investment on second-hand machines, was *birr* 10.2 million in 1998).

Soon after AE2 was set up, however, many newcomers including those that became dominant like D H Geda, East African Company, the Midrock Group, Ethiopian Steel entered the market and reduced AE2's market share. AE2 was also dependent on high value (multi-million *birr*) imports of raw steel that required, in 1998, over *birr* 7 million working capital. In addition, owing to the Ethio-Eritrea conflict *birr* 3.5 million worth of merchandise was stranded at the port of Assab. According to the acting manager, largely owing to the shortage of raw material and working capital, AE2 never used more than 15 per cent of its capacity. But in spite of all these problems AE2 was growing, for example, its workforce grew from 30 in 1994 to 51 in 1998. The enterprise also contributed *birr* 832 622 in income tax in 1998 but, as it will be explained, AE2 did not benefit from IIS income tax privileges.



**UE2 Wood and Metalwork Enterprise:** Semu, as the first born among five brothers and sisters, succeeded to his dead father's business as a manager at the age of 22 in 1985 (Semu, 1998). The pressure of running the business and looking after the family did not allow Semu to study beyond grade 12. Moreover, the business he inherited had only a limited future as it dealt with selling unprocessed wood (locally known as *atana*) used in the housing construction sector. From the start Semu was prepared to change the business into his 'childhood ambition' of furniture production. Hence Semu, while still running the family business, was learning the skills of woodwork from small scale private operators around him. Beginning from the late 1980s circumstances started to turn in his favour. For example, due to the expanding private sector, demand for office and household furniture increased and this instigated the birth of UE2.

Located in Mesalemia area, Addis Ababa, UE2 was born in 1992 and specialised in the manufacture of household and office furniture notably in the production and supply of school and hospital furniture and office equipment. Two new establishments (metal works and upholstery) were added to the major wood works factory. In terms of physical capital accumulation, in 1998 several operating lines were installed and these involved over 20 major machines in the wood works establishment alone, and five heavy trucks were purchased for transporting raw materials to the factory and finished products to all over the country. Following its conversion to a PLC in 1998 (with a *birr* 3 million registered capital) the head office has been expanded and the sales and accounts sections were modernised.

UE2 employed an experienced workforce including some graduates of technical schools from Addis Ababa. The key staff were attracted and retained, among other things, by the above average wage that UE2 paid. For example, two of UE2's most experienced and skilled technicians were induced to leave a government wood factory when offered higher salaries (from *birr* 700 per month to *birr* 1000)

and 5 per cent of the net profit of the business. Inherited resources such as a large enterprise site also played a role in the set-up of the enterprises.

Although eligible UE2 did not seek IIS's tax free import of machinery, equipment and heavy trucks. Step by step all machines and heavy trucks were purchased from local suppliers, as Semu explained, this was because 'the procedures at EIA were time-consuming ... and EIA support required a huge amount of finance at start-up. But we purchased our capital goods from local dealers sometimes on an instalment basis'. As of 1998, UE2 was one of the major contractors in the country in the production and supply of school and hospital furniture, office equipment, window, door and glass works. The business was continuously growing and was operating at its full capacity. A large investment plan was also under review (the major drawback of which, according to Semu, would be the availability of a serviced site). There was ongoing internal and external staff development (including training in computers). UE2 was also paying income tax (*birr* 25 000 in 1998).

**AE3 Agro-industrial Company:** AE3 was a brainchild of a retired beeswax trader who brought two of his daughters and colleagues to the business. AE3, whose headquarters was in Merkato, was set up in 1995 with an approximate investment capital of *birr* 20 million. The company initially started to operate mainly in the coffee hulling and export business, areas that the government considered as priorities and offered IIS incentives for. Coffee beans were purchased from all coffee growing regions and processed in Addis Ababa. Coffee was exported to regions as far as North America, the Far East and Europe (Amare Mamo, 1998).

Moreover, since 1995 the scope of AE3 business spread to three major activities that included chemicals and plastics, a beeswax processing plant and transport services. Major expansion was made to the domestic transport services which were operating with 28 heavy trucks in 1998. The workforce of the company also



grew from 26 in 1995 to 400 in 1998. Working capital too has risen to over *birr* 20 million. The head office was also reformed to cope with all these local and international operations. Moreover, a former government bank officer was brought in as a full time manager. The company was not only operating at full capacity but also intended to expand the business. Overall, as of 1998, AE3 was one Ethiopia's largest enterprises.

**UE3 Industrial Chemicals Company:** UE3 was a company set up in 1992 and headed by a well educated and experienced agricultural specialist. When the British company ICI closed its operations in Ethiopia in 1990, Markos the general manager of UE3 recalled that, he was seriously concerned about his future employment. He went on to say that '... when you want to deliver services to farmers you obviously need money. But it was not financial motives that pushed me into this business' (Markos, 1998).

After considering his options, Markos set up his own company in 1992 and started operating from its strategically located head office at Bole Road in Addis Ababa. UE3 operations included trading in agro-chemicals, veterinary services, industrial chemicals, and pharmaceuticals. The company also repackaged agricultural chemicals to suit the demands of farmers and field level chemical applications. UE3 was eligible for the IIS incentives but the founder did not seek the support because of the perception he held that the IIS was a bureaucratic organisation.

Markos chose to do business in an area that he was interested, trained and experienced in. He studied agriculture, which Markos said was 'a discipline related to my father's occupation'. He had worked for the Ministry of Agriculture in regional projects and in Addis Ababa, and ICI. Markos also gave credit to the support he gets from his family and the work ethics and discipline that he inherited from his parents. There were also favourable circumstances that helped the successful start-up of UE3. The main one was that when ICI pulled out UE3



bought, at a reasonable price according to Markos, some second-hand investment goods including 3 vehicles, furniture and equipment from the company.

Moreover, during the 'transition period' of system of government, Markos also unofficially bought what was otherwise a state owned enterprise site. This site was put aside to build a factory plant that would produce stationery materials.

In 1998 the company was operating in coffee, cotton and food crops producing five major regions of the country and the business was expanding and attracting qualified staff. The staff were 18 in 1992 and increased to 22 in 1998. The education (and salary) level of employees was high - there were 8 staff (out of 22) who held a minimum of a first university degree. Further, employees were offered short term training on basic codes of handling chemicals at the facilities of major suppliers abroad.

#### 5.4.2 The road to enterprise start up: the 'why' and 'how' questions

In this section, following a brief summary on case SMEs and entrepreneurs described above, entrepreneurs' motives particularly those related to IIS incentives for setting up enterprises are explored.

##### 5.4.2.1 Summary of entrepreneurs' motives for enterprise start-up

Table 5.7 below summarizes some of the features of case SMEs and entrepreneurs described in section 5.4.1.

**Table 5.7** Summary of some features of the entrepreneurs and enterprises

enterprise (legal form*)	start-up date	staple product/ service	jobs at start-up and 1998	age (at start-up) and sex of manager	manager's education level (grade)
AE1 (SP)	1992	shoes	8 & 20	46, M	12
UE1 (SP)	1992	shoes	6 & 17	31, M	10
AE2 (PLC)	1994	corrugated iron sheet, reservoir	30 & 51	42, M	University
UE2 (SP)	1992	building structures, and office furniture	40 & 130	29, M	12
AE3 (PLC)	1995	coffee hulling and export	26 & 400	47, M	University
UE3 (PLC)	1992	repackaging and dist. of agri. chemical	18 & 22	38, M	University

*Source: Organised from information supplied by the entrepreneurs  
(SP = sole-proprietor, and PLC = private limited company)*

From the evidence in section 5.4.1 and Table 5.6 it follows that:

- all the SMEs were set up in the first half of the 1990s following the introduction of economic policy that was supportive to the private sector. Three SMEs (AE1, UE1 and UE2) were organised as sole proprietors while the other three started as private limited companies. The head offices of all the SMEs were in Addis Ababa, and all (except AE1 and UE1) operated in the regions other than Addis Ababa.
- the enterprises were set up and managed by men in their late 20s to 40s. Some used hired managers (AE2 and AE3) while others were run by owner-managers. Some owner-managers had at least a first degree from a university (AE2, AE3 and UE3) whereas the others attended school. Some former government employees also became either entrepreneurs (as in AE2 and UE3) or senior member of staff in all the enterprises (except UE1).
- in terms of parental occupation, entrepreneurs of AE1, UE2, and AE3 came from trading families whereas UE1 and UE3 come from farming families. In all these SMEs immediate family members were key business partners. All

AEs entrepreneurs had successful experience of running their own businesses<sup>54</sup>.

- considering staple products of the SMEs that ranged from consumer goods like shoes to construction materials like corrugated iron sheeting, all these activities were eligible for the IIS support. However, whether an enterprise received a 'pioneer' or 'promoted' status was at the discretion of the authorities as enterprises had more than one function that did not fall under one category.
- in terms of performance (for example, growth in employment and investment plan), from this small sample it cannot be said that AEs or UEs did better than the other group.

What were the motives and triggers for enterprise start-up, and did the IIS have an influence on enterprise start-up? All the entrepreneurs gave more than one factor that had influenced them to start up their enterprises. Providing jobs for relatives featured as a reason for the set-up of AE1, UE1, UE2, AE3. The need for financial independence (AE1, UE1 and UE2) and the threat of unemployment (AE1 and UE3) were the driving forces behind the set-up of those enterprises. All upheld changes in the enabling environment that allowed entrepreneurs to engage in more than one business and employ capital without a ceiling. As far as the IIS was concerned, however, it was the founders of AE2 who took account of IIS benefits to set up the enterprise.

To sum up, the evidence showed that, for all the entrepreneurs, the underlying reasons for being enterprising were based on personal interest and experience in particular activity type, available resources, and formal and informal training received prior to setting up the enterprise.

---

<sup>54</sup> Note that some of these characteristics of the entrepreneurs follow the entrepreneurial pattern described in chapter three.



#### 5.4.2.2 Enterprise start-up resources

Given its vital role in enterprise start-up, this section thoroughly examines entrepreneurs' resources base. Moreover, the section considers whether IIS had a role in organising the resources considered. Owing to the severity of problems experienced by the entrepreneurs, however, the focus below is on enterprise site/premises and finance.

- (i) investment capital: the six entrepreneurs, between them, used at least six sources of capital: past savings, *ikoub*<sup>55</sup>, asset sale, bank loans, family and friends. Only the manager of AE1 used a maximum of four of these sources of capital. One most interesting finding here was that while all AE entrepreneurs used bank loans as a source of finance, none of the UE entrepreneurs did. This, as I will argue in section 5.5, suggested a link between the IIS and access to bank credit.
- (ii) enterprise site and premises: All the six SMEs had made applications to the Addis Ababa City Administration (and Land Lease Office) to acquire enterprise sites. The EIA and/or ministry of industry (MoI) were involved in the process of site acquisition by supporting entrepreneurs' applications (Table 5.8).

---

<sup>55</sup> *Ikoub* is an Amharic term for a traditional saving institution, where people come together at a regular meeting and each member contributes a predetermined amount of money; and lots are drawn for each non-winning member until everybody wins.

**Table 5.8** Acquisition of enterprise site: success and failure stories

enterprise	land area (m <sup>2</sup> )	institution involved	term of acquisition	waiting time
AE1	-	Addis Ababa Administration, MoI	-	3 years(failed)
AE2	1800	Addis Ababa Administration, EIA	freehold	< a year (succeeded)
AE3	1909	Addis Ababa Administration, EIA, and Lease Board	leasehold	< a year (succeeded)
UE1	-	Addis Ababa Administration, MoI	-	> 3 years (failed)
UE2	2500	-	inherited	-
UE3	1100	private/unofficial	freehold	2 years (succeeded)

*Source: Organised from information supplied by the entrepreneurs*

AE2 and AE3 managed to acquire sites with the help of the EIA and other government agencies in the shortest possible waiting time. AE2, in particular, was given a free land holding status. UE3 bought land (and some property) from a private individual before the land lease policy became effective. UE2 wanted to lease an area of 10 000 m<sup>2</sup> land but the manager failed to raise the *birr* 3 million land lease price, hence UE2 was set up on an inherited but small plot of land. AE1 and UE1, however, in spite of waiting for over three years, failed to acquire enterprise sites.

With regard to acquiring enterprise sites and premises entrepreneurs raised the following problems: (i) excessive bureaucracy and long waiting time. (ii) excessive corruption and abuse of power. (iii) high cost of land and site development.

Entrepreneurs said that subsequent to the introduction of the lease policy in 1993, land prices in Addis Ababa increased, from free allocation, to as high as *birr* 4300 m<sup>2</sup>. Entrepreneurs who considered moving to the outskirts of the city (like UE2) with a view to getting cheaper plots of land were confronted with severe bottlenecks of infrastructure like power and access roads.

Case SMEs adopted different coping strategies to overcome the problems of enterprise site/premises. Clearly AEs sought assistance from EIA to get access to land. Those who failed to acquire sites through the lease system (UE1 and UE2) rented premises by paying what was locally referred to as *ye'kulf waga* - or 'access' payment to a tenant of subsidised public premises for transferring the tenancy right to the entrepreneur.

Overall, invariably all the entrepreneurs had encountered severe land/premises acquisition problems, and the evidence suggested that access to and cost of land, particularly in Addis Ababa, was a major factor that either made or broke enterprise start-up.

#### 5.4.2.3 Entrepreneurs' idea development and project implementation problems

Entrepreneurs were asked to reflect on the problems they faced during project idea development and implementation stages, and whether they received public/private support in this regard. Responses to these questions are summarised below.

**Enterprise start-up problems:** Each entrepreneur nominated most of the following problems as 'most severe' start-up problems: shortages of resources, notably land/premises and bank credit, shortages of skilled labour both in quality and quantity, shortage of information such as about market demand, onerous procedures and corrupt public officials, and cultural barriers to doing private business such that some officials distrust the private sector. Also a catalogue of infrastructural problems like shortages of power, water and roads were listed.

Specific to the IIS, I found that entrepreneurs who purchased an imported machine from local dealers forfeited the main benefit from the IIS. Therefore, with the view to benefiting from the IIS entrepreneurs made direct import orders (that is avoiding local public/private dealers). This practice resulted in some adverse consequences: the first displacement effect was that owing to IIS licensed



entrepreneurs making direct import orders, local dealers or distributors of capital goods lost business. Second, IIS licensed importers also increased transaction costs (like search for suppliers and costs of handling imports). Moreover, entrepreneurs lacked experience in importing capital goods that led to mis-specification of orders. Both AE2 and AE1 reported delays in receiving import orders, and received mis-specified machines, costing both enterprises a huge amount of money.

**Becoming a legal entity:** Following the Commercial Code of Ethiopia (IGE, 1960), all enterprises (except for those which started under *birr* 5000 capital) were required to register with Ministry of Trade and Industry (or respective regional bureaux). According to the entrepreneurs, the legalisation procedures were cumbersome - they involved difficult procedures of producing memoranda of association, third party notification, and multiple registration at the Ministry of Justice, and regional and zonal layers of administration.

**Support in business idea development and implementation:** Respondents were asked if they had received any form of support (public or private organisations) through the process of enterprise start-up. The response especially that from UEs was an emphatic no. And all respondents said that they would have welcomed advice and support in the areas of machine import, project feasibility studies, accessing resources for project implementations, and entrepreneurial development skills. As discussed in chapter three, agencies that would have provided support to starting up enterprises were few and had limited capacity.

According to the three IIS assisted entrepreneurs, the limited advice they received from the EIA was useful. The support came as part of the qualification process for the IIS, in which the EIA indirectly guided project document preparation. The other most common support that entrepreneurs trusted and relied on (moral, advice, and lobbying with officials) came from friends and connections in or

outside government. However, some of the so-called advisors had some shortcomings - in that they knew very little about what was involved in enterprise start-up and provided, as happened to AE1, wrong advice on machine orders.

Section 5.4.3, beginning with entrepreneurs' awareness level of the IIS, explores whether the IIS influenced entrepreneurs' decisions over the choices of the timing of start-up, and the activity type, location and size of an enterprise.

5.4.3        Impacts of the IIS on enterprise start-up

5.4.3.1     Entrepreneurs' awareness levels of the IIS

Entrepreneurs awareness levels about the IIS are summarised in Table 5.9. All the six entrepreneurs were aware of the general provisions of the IIS, and with the exception of UE1, all knew about IIS supports in their proposed activity areas. The main medium of information was the media (radio and newspapers). All entrepreneurs (except AE1 and UE1) knew about the IIS at the early stage of enterprise idea development.

**Table 5.9      Entrepreneurs' knowledge about the level of IIS support**

pointers	enterprise/ entrepreneur
knowledge about the general provisions of the IIS	all
IIS support in proposed activity area	all but UE1
IIS awareness stage relative to enterprise idea development: - early at planning stages  - later at implementation stages	AE2, AE3, UE2, UE3 AE1, UE1
Types of IIS support received (AEs only): direct support: - exemptions from customs duties - exemptions from income tax - other support (eg tax relief on land development expenses) indirect IIS benefits (providing access to land, credit and utilities)	AE1, AE2 and AE3 none none AE1, AE2 and AE3

*Source:      Organised from information supplied by the entrepreneurs*

The three assisted enterprises (AEs) received direct support in the form of exemptions from import taxes. However, for the reasons given in section 5.4.3.2 below, none of these AEs actually received support in the form of relief from paying income tax nor taxes on other expenses incurred (like on R&D, site development, building construction, and machine installations). To varying degrees, all the AEs (especially AE2 and AE3) did get indirect benefits in the form of access to bank credit, enterprise site, and utilities.

#### 5.4.3.2 The IIS influences on entrepreneurs' start-up decisions and enterprise level IIS benefits

**The IIS influences on entrepreneurs' start-up decisions:** The impact of the IIS on enterprise start-up was the key question that the research was designed to investigate. None of the three UEs, in spite of being eligible, sought IIS support. The owner of UE1, even with his limited knowledge of the IIS had had a tormenting experience in the hands of public agencies while looking for an enterprise site, and was extremely pessimistic about any support from public agencies. UE2 and UE3 perceived the EIA as a bureaucratic institution, and decided not to consider its support.

AE entrepreneurs were asked whether they would have set up their respective enterprises had they not received the IIS support. Similarly, entrepreneurs of UEs were asked what impact the IIS would have had on their key decisions, such as on product choice, had they received the support. All responses were controlled to reflect variations in sector (product choices), location, scale of operation and timing of start-up decisions. Table 5.10 summarises the responses given by the entrepreneurs.

*First*, the IIS influence on entrepreneur's decision on start-up timing: It was found that entrepreneurs' decisions on the particular timing of starting up their enterprises (entry timing) was unaffected by the IIS. Views of all the respondents



consistently agree that the choice of the particular time for enterprise start-up was to do with the general change in policy but not the provision of IIS incentives. On the actual pace of start-up, because of delays in obtaining investment licences, UE2 thought that the IIS would have slowed down the start-up process.

**Table 5.10    Summary of key enterprise start up decisions: did IIS have an effect?**

Enterprise	Entry timing	type of activity	location of activity	scale of activity
AE1	No	No	No	Yes
AE2	No	Yes	No	No
AE3	No	No	No	No
UE1	No	No	No	No
UE2	No?	No	No	No
UE3	No	No	No	No

*Source:    Organised from information supplied by the entrepreneurs*

*Second*, the IIS influence on entrepreneur’s decision on product choice: None of the entrepreneurs’ decisions (except AE2) was influenced (or would have been influenced) by IIS incentives regarding the choice of activity type. AE2, the engineering firm, considered IIS assistance because of ‘entry into an unknown market where competition from imported products was strong’. The dominant factors that affected entrepreneurs’ decisions in choosing their respective activity types were:

- entrepreneurial interest (strong personal attachment either following family tradition or own experience, for example, UE1, UE2, UE3 and AE2).
- entrepreneurial knowledge of and experience in the production and marketing of a particular product/service (through formal training in the field like UE3 and AE2, and on the job training like UE1, AE1).
- potential growth of and current profitability of the activity (as in AE3, AE2, UE1).

*Third*, the IIS influence on the entrepreneur's decision on the choice of enterprise location: The IIS was a total deadweight with regards to influencing the choice of location as no single entrepreneur associated enterprise location decision with specific benefits of the IIS. According to the entrepreneurs, their location decisions largely rested on factors like proximity to central location (product market, suppliers of raw materials and labour), good infrastructure (like roads, power and utility), availability of site and premises, proximity to the entrepreneur's residence, and other factors including availability of spare parts, consultants, insurance and banking services, and social services like health and education in the chosen location.

*Fourth*, the IIS influence on entrepreneur's decision on scale of activity: Again none of the entrepreneurs (except AE1) thought that enterprise size at start up was (or would have been) influenced by IIS incentives. The owner of AE1 claimed that the IIS had positively impacted on the scale of his operation because he made a special effort to raise more capital and meet the minimum IIS entry requirement.

**Enterprise level IIS financial benefits:** The conclusion that emerged from the interviews, summarized above, was that the IIS barely influenced entrepreneurs' key enterprise start-up decisions like the choices of location and activity types. That may be the case, but entrepreneurs did gain some financial benefits from exemptions from paying duties on imported capital goods (pre-enterprise start up) and income taxes (post-enterprise start up).

*First*, pre-enterprise start up enterprise level IIS benefit: In Table 5.11 major machines and tools used by AE1 and UE1 are used to demonstrate the IIS financial benefits and losses of the two respective enterprises<sup>56</sup>. Both AE1 and UE1

---

<sup>56</sup> Organising data on tax savings made from exemptions from duties on capital goods was hindered by patchy records on the amount of machines and equipment imported by each case SME. Even when more and more data on the amount of machines and equipment imported were generated, the conclusions of case by case analysis did not improve as

were set up in 1992 before tariff rates were reformed mostly downwards. When Begashaw (founder of AE1) imported his machines (and Kadir, founder of UE1, purchased his from local distributors) the basic import tariff rate and sales taxes were 10 and 24 per cent, respectively. Based on these rates the total amount of duty saved by AE1 and (paid by UE1) amounted to about 25.4 per cent of value of the capital goods<sup>57</sup>.

**Table 5.11 Customs duty saved and paid: comparing AE1 and UE1**

purchased/imported tools and machines	value before tax ( <i>birr</i> )	duty rate	other taxes	duty saved or paid ( <i>birr</i> )	Total Cost ( <i>birr</i> )
AE1:					
(1) set cutting knives, upper sole	39675	10	24	13489.5	53164.5
(2) set cutting knives, insole	24140	10	24	8207.6	32347.6
(3) 2 sewing machines	46590	10	24	15840.6	62430.6
Total (1-3)	110405			37537.7	147924.7
UE1:					
(1) 4 sewing machines @ 4 000 <i>birr</i> each	11936			4064	16000
(2) 1 skiving machine @ 12 000	8952			3048	12000
(3) mechanically operated machines/tools	41030			13970	55000
Total (1-3)	61918			21082	83000

*Source: Organised from information supplied by the entrepreneurs, and own calculation*

individual entrepreneur savings from duties heavily depended on the tariff rates applied. Hence, below only two exemplar cases of AE1 and UE1 are discussed for illustration (for the national estimate of tariff rates see details in section 5.2 and Box 5.1).

<sup>57</sup> method of calculation: AE1 has incurred a total cost of *birr* 147 942.70 (purchase value plus duty saved) on the items given in Table 5.11. Savings from the IIS that was *birr* 37537.70, therefore, amounted to 25.4 per cent of the total cost of imported capital. The pre-tax purchase value of machine and tools for UE1, therefore, were approximated by deducting 25.4 per cent of the total cost as duties paid at customs office. Total cost of imported machine and tool, obviously, included costs of CIF and domestic distributors' profits. Consequently, the amount of 'duties' paid by UE1 may have been overestimated.



However, following the reform in the structure of Ethiopia's customs tariff in 1993, rates significantly fell, reducing IIS supported entrepreneurial benefit over 1993-98 to around 13 per cent of the value of capital goods imported<sup>58</sup>.

Although tariff rates have been falling and foreign exchange was made available for the entrepreneurs, other aspects of adjustment programme (such as devaluation, adjustment on prices of utilities and increase in interest rates) were adversely affecting their businesses. Some SME managers, therefore, argued that through the IIS the government was trying to compensate businesses for the high cost of doing business due to the adjustment programme. This meant that the IIS did not add to the finances of the entrepreneurs involved in the case study.

The two footwear factories (AE1 and UE1) provided some striking evidence on the likely influence of the IIS on investment and adoption of modern machines. As discussed before, UE1 not only paid taxes on imported goods but also used more locally produced tools. Moreover, most of the tools used by UE1 were simple, in that they were operated in either a mechanical or semi-electrical way. These tools, therefore, not only consumed less energy but also provided more jobs. The fact that enterprises like UE1 were less energy dependent meant that these enterprises tended to be regionally flexible. The evidence I generated from both cases of SMEs and interviews with the authorities showed that IIS incentives certainly encouraged capital importing by individual entrepreneurs. This meant that AEs incurred more transaction costs like CIF, and lost linkages between specialised capital importing local companies that provided advisory services like on installation, repair and maintenance of machines.

---

<sup>58</sup> For example, in 1998 ELNAL, a button producing PLC, imported machinery worth *birr* 1.5 million and saved *birr* 202 000 from IIS import related taxes (EEA, 1999). This amounted to 13.5 per cent of savings, closely confirming the 13 percent national estimate I made in section 5.2.

*Second*, post enterprise start-up impacts of the IIS<sup>59</sup>: entrepreneurs were asked whether more income tax relief (in years) would have induced investment to move into remote regions. Three of the entrepreneurs (AE1, AE2, UE2) said that they would not be persuaded by any number of years or level of tax incentives to go to the regions. The reasons behind this position were based on simple cost and benefits analysis: infrastructure (roads, power, etc.), availability of skilled labour, problems of separating work place from residence areas, and even law and order, according to the entrepreneurs, worsen if they move out of the centre. Some of the enterprises (AE2, UE2, AE3 and UE3) were already operating in the regions (including in the remote regions). AE3 founders welcomed any improvement to the tax system but tax concessions would not have influenced where they have operated. UE3 was happy to operate where his enterprise was welcomed, and for UE3 the most important issue was not receiving incentives but eliminating existing barriers to enterprises especially in business registration and legalisation in the regions.

Regarding income tax benefits, none of the assisted enterprise benefited from income tax relief, for different reasons. AEs' exemption from income tax was conditional on enterprises keeping financial records. The relatively smaller enterprise (AE1) missed out on tax benefits on the grounds that the enterprise could not afford resources for keeping records. Moreover, because AE1 had the incentive and legal rights that did not require record keeping, he preferred fixing a long term and favourable flat tax rate with local tax authorities. Secondly, the relatively bigger enterprises (like AE2) started operations at less than full capacity and hence were barely profitable after start-up. By the time the business had

---

<sup>59</sup> From the interview I had with entrepreneurs, in the post enterprise start-up situation, the following emerged as key constraints to enterprise growth: inadequate or lack of enterprise site/premises, punitive tax system, lack of transparency and efficiency in the bureaucracy, inadequate infrastructure, lack of access to banks and to the services of utility companies. But the IIS assistance failed to directly address these problems.



become profitable the income tax exemption privilege had expired. Overall, the important conclusion that emerged from the case SMEs was that exemption from paying income tax was not of any consequence either to the set up or growth of the three AEs. In this regard, therefore, the IIS was a total deadweight.

*Finally*, I asked entrepreneurs if there were trade offs between IIS benefits and costs due to licensing procedures and waiting time for an investment licence. Views, however, were markedly different between AEs and UEs. UEs thought that the investment authorities were bureaucratic, costing enterprises money and valuable start-up time. AEs' views (overall) tended to confirm the official view, in that the procedures were simple, the *birr* 200 licence fee was 'peanuts' to pay, and waiting time for a licence took a maximum of two months.

To summarise, the evidence from cases of SMEs presented in section 5.4 showed that IIS incentives did not motivate entrepreneurs to start up enterprises. Nor were entrepreneurs' decisions over the choices of location influenced by IIS incentives. However, the choice of type of activity and enterprise size were marginally influenced by IIS incentives. Moreover, as I will argue in section 5.5 below, some AEs used the IIS licence and structure and drew on some superior benefits from subsidised and/or easy access to enterprise site, bank credit and utilities.

### **5.5 Access to key enterprise start up resources**

Based on the macro statistics presented in section 5.2, the investment authorities claimed that IIS incentives influenced the location pattern of enterprise start-up in favour of locations outside the dominant region Addis Ababa. However, the evidence that emerged from the case SMEs, and reported in section 5.4, led to the conclusion that the IIS did not influence entrepreneurial location choices. Section 5.4 also showed that, some entrepreneurs used IIS licence and structure to get subsidised access to one or more enterprise start up resources like enterprise sites.



In this section I present a rival explanation to the statistics given in section 5.2 that appeared to have shown a new pattern of enterprise location. Owing to their importance to the entrepreneurs, the evidence presented in this section focuses on land, credit and energy. As of 1998 the state had an absolute monopoly in the ownership and distribution of these resources. Because the claim and counter claim on the spatial effect of IIS incentives revolved around Addis Ababa versus the rest of Ethiopia, land based data were particularly collected from the Addis Ababa land lease office. Two national agencies, the Development Bank of Ethiopia (DBE) and Ethiopia Electric Power Corporation (EEPCO) also served as source of evidence.

The presentations below summarise answers to questions like whether the relevant agencies, as claimed by the entrepreneurs and investment authorities, allocate land, credit and power on a discretionary basis. And, if that was the case, how important were the benefits in affecting location patterns of enterprises? Section 5.5.2 below deals with access and cost of enterprise sites, and section 5.5.3 focuses on electric power and bank credit.

#### 5.5.1 Access to and cost of enterprise site

##### 5.5.1.1 Brief background to the political economy of access to land

The constitution of Ethiopia showed that the government retains ownership of all land in the country (FDRE, 1995a). However, land continued to be made available through the land lease proclamation passed in 1993 (TGE, 1993). Following the constitution and the lease policy, the nine regional states and the two city governments passed their own land lease policies to regulate the acquisition and transfer of land. At the national level, duration of lease broadly varied between activity types - while the maximum lease period was 99 years, for example in manufacturing the lease holding period was 60 years. 'Prices' of lease too varied

between regions and locations within regions and specific use of land. Land allocation was also based on auction and non-auction lease holding systems<sup>60</sup>.

The procedures put in place for leasing land (especially as practiced in the Addis Ababa land lease office (LLO)) were burdensome and involved huge transaction costs to the entrepreneurs. Identification and preparation of an area into plots, developing area maps, and specifying the uses (like industry and/or service) and building regulations took a considerable amount of time and resources. Auctions were also infrequent and met the demands of only a few entrepreneurs. For example, over 1995-98 the Addis Ababa LLO held 20 rounds of auctions, offering a total of 385 individual plots of land of which only 150 plots of land were leased to entrepreneurs. This figure compares poorly with the number of entrepreneurs that would have sought land as there were 1677 IIS licensed projects in Addis Ababa alone over 1992-98.

Interviews I conducted with land lease officials and entrepreneurs in Addis Ababa provided several reasons for the poorly handled land leasing: that land auction was a new practice to the country, the LLO had only a few bidders at one particular time, plots were often not to the liking of entrepreneurs (notably in terms of size, location and time of availability), and auction was expensive to entrepreneurs, in that bidding increased the land price. Factors like where the entrepreneurs lived and the social environment they had also limited them to their immediate areas. To overcome these difficulties, as one senior Addis Ababa LLO officer explained, IIS licence holders were assisted to get access to enterprise sites (Fikre Buta, 1998).

---

<sup>60</sup> Auction based land lease holding, in which a minimum of three people took part, was the dominant policy on accessing entrepreneurs to land holding. The non-auction sub-system, started in 1997, allowed entrepreneurs to choose better serviced sites and pay lease prices decided by the authorities. (There were also two other subsystems, cooperative and lottery allocation. However, these subsystems applied only to those who required land for building private residential houses.)

To sum up, via regulations and memoranda (not made part of the investment code) some IIS licence holders were given priorities to have access to enterprise sites. Moreover, as I will show below, land was leased to these entrepreneurs at subsidised lease prices.

#### 5.5.1.2 Cost of enterprise site

This section shows, first, the significance of the cost of enterprise sites in the total enterprise start-up cost and, second, the extent to which subsidised land was allocated to some IIS licence holders in Addis Ababa and the rest of Ethiopia.

(i) Data on Addis Ababa: two sets of data were used<sup>61</sup>:

- data set one was based on information on 'lease acquisition requested' obtained from EIA. These data covered 78 Addis Ababa based projects which were granted investment licences between 1992-97 and had complete data on land requirements and investment plans.
- data set two was based on 'lease acquisition accorded' obtained from the Addis Ababa LLO. These data covered 1997-98 land lease holdings accorded to a total of 169 IIS licensed enterprises of which only 63 had information on size and value of land acquired, and total investment at start-up.

The most common location of the sites in data set two was in the outskirts of Addis Ababa in places like Kaliti. In these locations lease 'prices' varied from *birr* 185 to 1800 per m<sup>2</sup> and the average price of 169 enterprise sites was *birr* 392 m<sup>2</sup>. However, in the heart of Addis Ababa notably in Merkato and Piazza lease price was as high as *birr* 4300 per m<sup>2</sup>. The average lease price, *birr* 392 m<sup>2</sup>, used in this calculation was, therefore, lower than what would have been representative of the whole of Addis Ababa.

---

<sup>61</sup> In both data sets a big variation ranging from 180 000 m<sup>2</sup> to 446 m<sup>2</sup> (on acquired land) and 76 000 m<sup>2</sup> to 350 m<sup>2</sup> (at plan stage) were observed. Such large tracts of land were often acquired by foreign companies such as MIDROCK Eth. Hence with a view to reflecting site requirements and costs for only indigenous enterprises these few foreign owned company statistics were excluded from both data sets.



These 78 and 63 projects from the first and second sets of data, respectively, were organised and compared in Table 5.12. Accordingly, the cost of land in total enterprise start-up cost accounted for 18 per cent (reckoned at the actual average lease price this amounted to doubling the amount made at the application stage). The average land size of enterprises was higher after plots were leased as opposed to at the planning stage. This was unexpected as entrepreneurs often enter into lease for less than what was indicated in their original project plans. However, the possible explanation could be that, acquired land on lease (column three) did not represent smaller enterprises, as the average was affected by fewer but medium to large enterprises.

**Table 5.12 Cost of enterprise site (in *birr* '000) in Addis Ababa**

pointers	lease acquisition requested	lease acquisition accorded
number of enterprises	78	63
average land (in m <sup>2</sup> )	3348	10360
average spending on land ('request' @ birr 392/m m <sup>2</sup> )	1312	2985
average non-land start up cost	11998	13595
total start up cost/enterprise	13304	16580
land cost/total start up cost	9.9%	18%

*Sources: EIA and Addis Ababa Lease Office unpublished data and own calculation*

The Addis Ababa LLO data on 169 plots leased between 1997-98 were further analysed. And of these 169 plots 33 of them were allocated to the entrepreneurs from free to a maximum of 35 per cent of market price of the lease as shown below:

- seven plots were allocated free of charge;
- ten plots were allocated at only less than 20 per cent of market price.
- fourteen plots were allocated at only 20-30 per cent of market value, and

- two plots were allocated at 35 and 100 per cent of market prices for the plots.

(ii) **Data on the rest of Ethiopia:** Enterprises that were starting up in Addis Ababa and major urban centres were predominantly manufacturing and services based. And in major urban centres land lease was relatively more expensive than rural land. For example, in smaller towns of Oromia, and outside 10km radius of Addis Ababa, in 1998 land lease per m<sup>2</sup> was only *birr* 2.10 (Tahir Aman, 1998). To reflect on circumstances that apply to rural Ethiopia data were organised on agriculture based enterprises. By going through EIA data files, applications made to undertake agricultural activities in three major regions, Amhara, Oromia and Tigray produced 80 enterprises that had data on size of land requirement, planned investment and expected jobs (Table 5.13).

**Table 5.13** Agricultural enterprise land costs in Amhara, Oromia and Tigray regions

pointer	Amhara	Oromia	Tigray	Total
no of farms	27	10	43	80
average farm size (ha)	1261	979	323	721
land price/ha ( <i>birr</i> )	65	150	20	78
average farm land price/farm (@45 years <sup>62</sup> , '000 <i>birr</i> )	3694	5945	291	2146
average farm investment on machines ('000 <i>birr</i> )	7319	2631	6326	6199
average farm building and other capital expenses ('000 <i>birr</i> )	4746	4996	1071	2802
average farm total investment ('000 <i>birr</i> )	12065	7627	7397	9001
jobs/farm	283	643	389	385
average farm expenditure on land (2146) as per cent of total investment (2146+9001=11147)				19.0%

*Sources: EIA (1998) unpublished data and own calculation*

---

<sup>62</sup> Note that the bases for calculating land prices for Tigray, Oromia and Amhara, respectively, were Hammond (1994), Tahir Aman (1998) and AIO (1995). Following the common practice in the Oromia region, estimates were made @45 years for all regions so that regional variations were compared based on a common denominator. Also note that prices were not weighted.

Table 5.13 showed that size of farms and lease price per hectare varied between (and within) regions. There was a big variation in the duration of land lease between regions such as 20-50 years in Oromia and mostly 20 years in Amhara and Tigray. The official land price/ha<sup>63</sup> for Oromia, Amhara and Tigray regions were *birr* 150, 65 and 20 respectively. Overall, the empirical evidence compiled in Table 5.12 showed that cost of land was significant, accounting for about 19 per cent of the total enterprise start-up cost.

To sum up, the empirical data presented above strongly suggested that the land lease policy played a large part in slow implementation of IIS licensed projects in Addis Ababa or pushing businesses to the outskirts of the city. However, some IIS licensed projects were assisted to acquire subsidised plots of land. Overall this meant that, because of the importance of land and its cost in enterprise start-up cost the key factor that shaped the spatial patterns of enterprise start-up around Addis Ababa was the land lease policy but not the IIS. The policy implication of this was that the government can better influence the spatial pattern of enterprise start up through its land policy than the IIS. Section 5.5.2 below considers entrepreneurs' access procedures to and cost of electric power and bank credit.

### 5.5.2 Access to electric power and bank credit

**Access to Electric Power:** Information generated from the Ethiopian Electric Power Corporation (EEPCO) showed that in 1998 only 13 percent of the population, and 421 out of over 600 urban centres, were supplied with electric power. EEPCO was also the sole producer and supplier of electricity in the country. Electric power supply to consumers (domestic, industry and service sector users) was made in three lines: public (government and public enterprises),

---

<sup>63</sup> There were also unofficial but limited land leases by peasants. Peasants leased their lands with tacit approval of the government, for example, a contractual agreement documented at the EIA showed a lease arrangement made between Eskindir Yoseph of the Meskal Flower PLC and Edo Burka of Meki town, Oromia Regional State. Meskal Flower paid the said peasant *birr* 350/ha for 20 years. See also Gavian and Gemechu (1994).



investors with investment licences, and a category referred to as 'others' such as businesses. The interview conducted with Alemu Egiso (1998) showed that the procedures for getting access to electric power were based on the ownership status of the client and the client's relation to the investment authorities. Public institutions and entrepreneurs with investment licences had direct access to power upon request (often within a month). Moreover, an EEPCO spokesman stated that '... EEPCO provides power to investors who have investment licences *yiwal yider saibal*. - as a matter of urgency' (Sendeku Araya, 1998). The category of 'others', however, were rationed energy on the basis of a first-come-first-served principle taking, on average, 3-4 months (Alemu Egiso, 1998).

**Access to bank credit as experienced at DBE:** According to the interview (Getachew, 1998) and additional information I was given, in 1998 the Development Bank of Ethiopia (DBE) provided credits for enterprise development (start-ups and expansions). Similar to the land lease office, DBE's loan extensions were based on cumbersome procedures. First, a thorough feasibility study of proposed projects was made by the bank; and, secondly, entrepreneurs were obliged to fulfil the following conditions: (a) have a work permit. (b) provide an investment certificate, if there was one. (c) have a certificate of commercial registration. (d) have completed land lease agreements with local governments. (e) provide proformas of invoices with details of fixed and consumable assets. (f) incorporated businesses had to produce memoranda and articles of association; and there had to be a designated manager.

Entrepreneurs, those I studied complained about the banking system because its interest rate and collateral requirements were 10.5 per cent and 125 per cent, respectively. In addition at least 30 per cent of a project cost had to be paid by equity capital. The bank did not provide credit for working capital, and took 3-4

months to process loans (largely because it did not have the required number of staff).

However, according to a senior DBE expert (Getachew, 1998), the bank was not the only party to blame. Many clients had little management skills and came up with business ideas in 'tested but saturated' areas. The people who came up with these poorly developed ideas ended up in the less competitive and low quality producing activities. Secondly, other factors like currency devaluation raised machine and raw material costs, the poor infrastructure (including information systems), and the bureaucratic procedures of land allocation all adversely affect the operations of the bank as well as the entrepreneurs.

To sum up, most of the conditions for entrepreneurial access to resources (at DBE and EEPCO) were intertwined with the operations (and conditions) of other agencies like regional land lease offices. Entrepreneurs were required to go through multiple agencies (and units within agencies) to get access to an enterprise site, energy source and bank credit. Success in one area progressively depended on the outcomes of preceding stages. As, for instance, to extend bank loans DBE required proof of a land deed agreement between an entrepreneur and the land lease board, and for speedy allocation of land the land lease office required an IIS licence. In this inter-linked situation some of the IIS licence holders were helped in a coordinated fashion and provided with cheaper and faster access to resources like enterprise sites.

Therefore, the conclusion that followed the foregoing analysis was that, as well the IIS benefits from investment incentives, it was easy and cheaper access to resources that made some entrepreneurs use the IIS licence and structure. The overall development implication of 'access to resources' was immense - in that it was making or breaking enterprise start up. As an IIS official Tahir Aman (1998) said the 'government needs to seriously consider the effect of land lease on

business start-ups'. Among the many implications of this finding was that, contrary to the intentions of the government, many non-IIS entrepreneurs were switching their plans to activities like services that required less working space.

## 5.6 Summary of the major findings

Drawing on multiple sources of data, this chapter presented the findings from the enquiry into the role and impact of the IIS on enterprise development. In brief the main findings were that:

- (i) **two broad enterprise level direct IIS benefits were identified:** first, the investment authorities provided limited pre-IIS licence advice on project preparation and information input on such areas as market demand that assisted entrepreneurs in strengthening their ideas of enterprise start-up. Second, exemption from paying import taxes on capital goods generated savings to the entrepreneurs that amounted to 13 per cent of cost of imported goods. However, entrepreneurs' financial benefits from exemptions from paying income taxes were found to be insignificant because the SMEs hardly made profits during the leave period and/or were unable (or unwilling) to comply with the regulation that required financial record keeping.
- (ii) **the IIS mediated enterprise start-up:** the IIS structure provided some assisted enterprises with access to such resources as enterprise sites. Free access to an enterprise site alone, for an average manufacturing and agricultural enterprise respectively, saved up to 18 and 19 per cent of the respective total costs of enterprise start-up. Moreover, providing access to subsidised resources like land profoundly affected enterprise start-up pace, size and growth.
- (iii) **IIS influence over entrepreneurial decisions on enterprise start up was limited:** at least based on the cases studied, the IIS neither motivated SME start-up nor influenced enterprise location. However, the IIS appeared to have had marginal influence over the choice of activity type and size of an enterprise. The enabling environment for the private sector, entrepreneurs' interest in and knowledge and experience of the chosen activity, market and physical and social infrastructure were among the crucial factors that influenced decisions over the key features of enterprises.



- (iv) IIS offered limited entrepreneurial benefit but huge social cost: fiscal and transaction costs obtaining IIS licence were small that is only *birr* 200. Further, the IIS licensing procedures were clear and simple, and took ten days to two months. However, the social costs of the IIS were: (a) administration cost of the IIS structure (including paying for up to 500 employees). (b) a minimum of *birr* 526 million government revenue from import taxes have been foregone over 1992-98. And (c) the IIS caused displacement effects to other businesses. This had a different nature: first, to take advantage of import duty exemptions, IIS licensed entrepreneurs imported capital goods by themselves. This affected companies that import and distribute capital goods. Second, direct machine/equipment import by IIS assisted entrepreneurs also adversely affected the entrepreneurs themselves. These entrepreneurs incurred more transaction costs like search costs of sources and prices of machines, and handling imports, delays in the delivery of consignments, and subsequent losses of local advisory support to install and maintain machines. Finally, some IIS assisted enterprises in the cooking oil processing sector were reported to have caused adverse effects on older enterprises.

In conclusion, therefore, the claim that the IIS policy has supported thousands of new enterprise start-ups was misleading and not sustained by the evidence. Over 1992-98 there were 4642 enterprises licensed for IIS support but only 27 per cent of these enterprises actually started up. Of these enterprises that successfully started up less than two in five of them actually drew on part of the IIS benefits. Moreover, most IIS benefits were appropriated by larger enterprises set up in the least supported location of Addis Ababa. Overall, as I will argue in the next chapter, most of IIS assisted enterprises would have been set up without investment incentives. The IIS, therefore, barely added to enterprise start up and early growth. The IIS licence, however, played a superior role by providing access to some entrepreneurs to subsidised resources.

Drawing on the theory (chapter two) and background analysis and discussion on Ethiopian enterprise economy (chapter three) and the findings summarised in this chapter, in the following two chapters I discuss the two central hypotheses of this

thesis. In chapter six I will discuss the extent to which investment incentives influenced entrepreneurial decisions over the timing, type, location and size enterprises. Chapter seven discusses how IIS mediated successful enterprise start-up by offering entrepreneurs easy and cheap access to key enterprise start-up resources.

## **6. Discussion on the Role and Impact of the Investment Incentives Scheme on Enterprise Start-Up**

### **6.1 Introduction**

The central objective of this chapter is to discuss the role and influence of investment incentives on SMEs start up as set out in hypothesis one (H1):

- H1: the influence of investment incentives on the timing, type, location and size of IIS assisted SMEs was limited.

Section 6.2 begins by exploring the link between IIS objectives, instruments and rationales. The discussion aims to demonstrate whether IIS objectives were justified and had adequate means of implementation. The conclusion that emerges from this discussion serves as an early pointer of the likely impacts of the IIS on SMEs start ups.

Section 6.3 outlines the framework for exploring hypothesis one. Then based on this framework, section 6.4 explores the links between the IIS and the dimensions of enterprise start-up (that is the timing, and the choices of industry, location and size and enterprise). Section 6.5 evaluates the performance of the IIS by examining IIS benefits and costs at enterprise and macro levels. Section 6.6 discusses the explanations for the limited IIS impacts on enterprise development in Ethiopia. Finally, section 6.7 provides the conclusion of the chapter.

### **6.2 IIS objectives, instruments and rationales**

As indicators of impacts of the IIS, and preliminary step to exploring hypothesis one, this section aims to establish whether IIS objectives were justified and had adequate means of implementation.

As recently as 1992 the IIS long term objectives was stated as accelerating social and economic development. Following this overarching objective, a list of



objectives were published in the 1992 and 1996 investment codes (see summary in Table 6.1, column 1).

First, Table 6.1 shows that the IIS had several objectives, but only investment incentives as a means of achieving them. Moreover, a careful matching of IIS objectives and instruments (that is the investment incentives) shows that (i) of the nine objectives listed only four (objectives 3, 4, 5 and 6) were directly backed up by investment incentives<sup>64</sup>. And (ii) investment incentives were only implicitly linked to other objectives (objectives 1, 2, 7/8 and 9). Of these second category of objectives, for example, it was not clear how and which particular resources were going to be exploited (objective 1). Assuming that 'resource exploitation' referred to enterprise start up, as in irrigation farms using ground water, the IIS incentives gave attention to the machines and equipment deployed but not to the particular resource exploited (say by using alternative labour intensive methods). Similarly, it was not clear how incentives that encourage the deployment of more physical capital was meant to create more jobs (objective 9). Therefore, I argue, the fact that the IIS had several objectives but only limited (and poorly matched) means of achieving them had adverse implications for its impacts.

---

<sup>64</sup> In addition to incentives, the IIS regulations partially lifted prohibitions that limited private investment (foreign and domestic) in some sectors of the economy. In particular foreign investment (objective 6) was promoted by providing regulations that guaranteed and protected investment in Ethiopia. But, in the strictest sense of the term, these do not constitute investment incentives (see chapter two, section 2.3).

**Table 6.1 Objectives and instruments of the IIS and its inferred rationales**

<b>objectives</b>	<b>inferred rationales</b>
1. exploit and develop natural resources	sustainability of the production system
2. increase the variety, quantity and quality of goods and services produced	promote competition
3. strengthen sectoral linkages	linkages and spillover effects
4. strengthen integrated and balanced regional development	spillover effect, compensation, and regional development
5. increase the role of indigenous private sector	competition, compensation for inadequacies
6. increase the role of foreign investment	competition, knowledge transfer and compensation
7/8. increase foreign exchange earning and save foreign exchange via the production of import substitutes	increase wealth, infant industry argument
9. create employment	reduce unemployment

*Source: (TGE, 1992), (PDRE, 1996a) and COM (1996), and own interpretation*

Second, the other IIS flaw was that reasoning behind the IIS objectives has never been articulated. This, as discussed above, resulted in the ambiguous nature of the possible outcomes of IIS objectives. The rationales for the IIS discussed below are only inferred from the evidence generated for the thesis (Table 6.1, column 2) and some of this evidence is directly referred to below:

**(i) strengthening the sustainability of the production system:** In support of this rationale, a senior government official in charge of IIS policy argued that:

Our policy direction [the IIS] is to move activities towards a more sustainable economic base. This means that, for example, in agriculture we have to move away from rain-fed and weather dependent farming to irrigation farming. (Tsfaye Belay, 1998)

Although IIS instruments were weak to cause effect, this rationale was based on the fragile nature of the Ethiopian economy and society. Ethiopia's mainstay has always been weather dependent agriculture. Moreover, it is common knowledge

that the country is vulnerable to drought and famine every time the rain fails. Hence public policy that encourages the use of natural resources like water with a view to sustaining the production system and cutting dependence on government and overseas aid justifies the IIS initiatives. However, the big question was whether the IIS was the best policy available and whether in practice it worked without adverse effects. For example, in the 1990s there has been a concerted government effort in expanding irrigation projects. But the adverse effect of water bodies created for expanding irrigation farming was a 'sevenfold increase in malaria cases' (*Observer*, 25 Feb. 2001).

(ii) **promote competition:** one key IIS objective (objective two, Table 6.1) was meant to promote competition by encouraging more enterprise start ups. The economic and political reasons, among other things, included that an increase in the number of enterprises in the economy creates healthy competition and strengthens the rather weak backward and forward linkages in the production processes. Moreover, the argument for competition was signaling the shift from state production of goods and services to private sector including the participation of foreign direct investment.

(iii) **strengthening linkages and spillover effects:** the rationale is that targeted sectoral support through the IIS encourages the weak linkages between sectors, for example, via subcontracting. Regional linkages also expand the domestic market and export, and FID links domestic production with the rest of the world and facilitates technology adoption.

(iv) **addressing inequality in regional development and promoting political stability:** differing activities in levels of development (or the perception of it) between regions of the country has been among the causes of political instability and regional fragmentation in the country. This also meant that problems of regional development cannot be left alone, as the neoclassical economists would



argue, to 'self-correcting' market mechanisms nor wait until growth benefits 'trickle down'. Investment incentives, in the view of Ethiopian authorities, are therefore one means of addressing regional development problems.

**(v) incentives as compensation:** the Ethiopia economy suffers from many kinds of distortions such as policy induced taxes, and most of all, spatial differences in the distribution of social and physical infrastructure. Hence the investment incentives, as an EIA official argued, encourage enterprise start-up and compensate for added costs to enterprise start up:

... in the peripheral parts of Ethiopia the business environment is extremely poor and hostile. There are hardly any SMEs there. Therefore, we grant the best of the IIS support to new enterprise start-ups in the peripheries. (Tefaye Belay, 1998).

**(vi) infant industry argument:** as Tefaye Belay (*ibid*) argued this was one of the strongest rationales for the IIS:

... in industry the policy is to move to basic and strategic industries like engineering, machine tools and cement factories. We recognise that activities like irrigation, agriculture and basic manufacturing require more investment and longer payback periods, thus we prioritise these activities through the IIS support. (Tefaye Belay, 1998)

The IIS also protected indigenous enterprise start-ups by lowering the entry requirement for the IIS relative to foreign investors, and assigning a reserve schedule exclusively for indigenous entrepreneurs. However, although the IIS protected indigenous enterprises, it did not send positive signals to foreign investment and competition. Relatively small foreign owned enterprises were systematically prevented from entering Ethiopia, this may have limited the opportunity that these enterprises might have contributed by way of skills transfer.

**(vii) reducing unemployment:** In the urban centres of Ethiopia the unemployment rate was about 40 per cent in the early 1990s (AAU, 1995).

Expanding employment opportunities, therefore, improves the livelihood of the unemployed and reduces crime (like theft and vandalism) associated with some jobless youth.

To conclude, the foregoing discussion showed that the IIS had several objectives but only limited means of achieving them. Moreover, the rationales for investment incentives had not been carefully considered right from the start and this led to the ambiguous nature of some possible outcomes of the IIS objectives. As discussed in chapter one, the authorities also failed to place enterprise support in the context that it produces results - that is they over-identified the investment problem and responded with a single-theme solution (investment incentives). Furthermore, the authorities barely considered the circumstances that influence entrepreneurs' behaviour, their attributes like education level on the take up of the IIS. All these, I will argue, are the preliminary pointers to the limited impacts that the IIS generated on enterprise start up and development.

Section 6.3 below outlines the framework for discussing IIS impacts on the key dimensions of enterprise start up (the timing, and entrepreneurial choices of industry, location and enterprise size).

### **6.3 The framework for discussing IIS impacts on enterprise start up**

#### **6.3.1 Conceptualising enterprise start up stages and the theoretical links**

Chapters two and four considered enterprise start-up as a process involving decisions to set up an enterprise and mobilising resources to begin operation (Birley, 1989). Moreover, chapter two discussed studies which put key enterprise start-up processes in stages. Fisher (1988), for example, identified five of these stages: idea generation (stage one), validation and conceptualisation of idea (stage

two), preparation on start-up (stage three), initial implementation (stage four) and stabilisation (stage five).

These stages, however, dealt with unnecessary details and separated most related functions of the entrepreneur. In Fischer (1988), for example, choosing product types and alternative location (stages two) was separated from testing the feasibility of the business idea (stage three). Moreover, elements of the five stages particularly that referred to business plans or marketing strategies (stage three), albeit important, were not an essential part of the IIS support. Therefore, in this thesis the five stages are condensed into the following three stages (see Figure 6.1):

- stage one: enterprise idea generation and conceptualisation,
- stage two: resources mobilisation and project implementation, and
- stage three: commencing producing goods and services and stabilisation.

In brief these three stages are conceptualised as follows:

**Enterprise idea generation and conceptualisation (stage one).** This stage includes enterprise idea generation and conceptualisation leading up the stage of acquiring an IIS licence. This means that at this stage the idea to start an enterprise has emerged and taken shape. Furthermore, the industry and location of the enterprise are chosen. Depending on the motivations and skills of the entrepreneurs, the overall viability of the project idea is also tested. In theory the test for project viability, among other things, takes into account the possibilities of obtaining external assistance (but not all entrepreneurs necessarily follow the same strategy).

The relevant theoretical links here are those that motivate (or impede) entrepreneurship (chapter two): the profit motive, risk taking behaviours and managerial competence; and social-psychological explanations such as need for independence, positive parental influence, religion and cultural attitudes.

Similarly factors that influence the dimensions of enterprise start up (location,



industry and size) include founder's resources, experience and training, infrastructure, market and roles of government incentives.

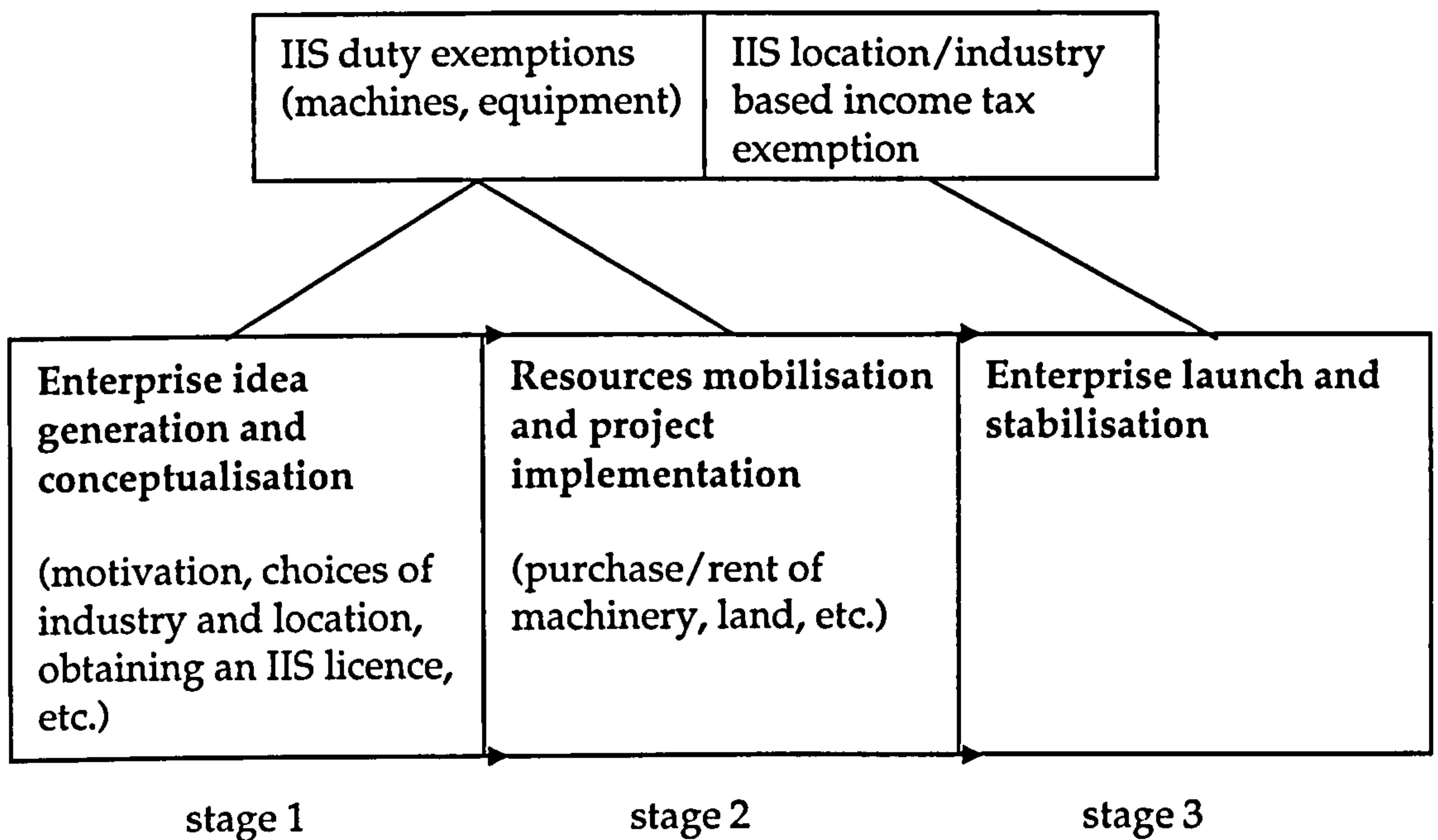
**Resources mobilisation and implementation (stage two).** At this stage an SME founder, first, mobilises financial and material resources needed to set up the enterprise. This refers to the purchase or rent of machines and equipment, enterprise site, etc. Second, the entrepreneur implements or performs the physical construction of the project and makes it ready for launch (stage three). Moreover, access to essential systems like power, communication, water supply, etc. are either completed or under implementation.

**Commencing producing goods and services and stabilisation (stage three).** Among the key functions of the entrepreneur at this stage are employing the workforce, assembling the raw materials, completing installations of the necessary systems that were not complete in stage two such as communication, organisation of work processes. Finally the project is launched. The discussion in section 6.4 also looks at early stage of growth stabilisation (a stage that IIS income tax provisions operate on)<sup>65</sup>.

---

<sup>65</sup> There are many functions of the entrepreneur that were not clearly identified in the above three stages. One example of these functions is undergoing the business legalisation process. In Ethiopia, because there are different forms of business legalisation (like expression of intent to set up an enterprise (stage one), building permits (stage two), or licence to start offering goods and services (stage three)) it is difficult to put these in one box. As Figure 6.1 shows some entrepreneurial functions overlap and can be performed concurrently.

**Figure 6.1 Enterprise start up stages and the role of investment incentives**



As in stage one, stages two and three are linked to theory and practice such as the political economy of access to resources discussed in chapter two, and a host of factors that enhance or limit project construction and successful launch.

As Fig. 6.1 shows the three enterprise start up stages are closely related and often overlap. The IIS incentives as a source of motivation to start up an enterprise, and influence of entrepreneurial choices of industry, location and enterprise size are shown in the framework (that is in the top two boxes). Specifically, duty exemptions are meant to impact on stages one and two (and indirectly at start up an entrepreneur could also anticipate income tax benefits in stage three). Income tax exemption is meant to directly impact on stage three (and IIS benefits at stages one and two may have acted as part of the motivations to get to this stage). (Note that to avoid complications, indirect impacts of duty and income tax exemptions

are not mapped out in Figure 6.1). The big question that follows is whether IIS incentives are sufficient to motivate an entrepreneur to start up an enterprise and influence his/her decisions over the choices of industry, location and the size of the enterprise.

### 6.3.2 An outline of hypothesis one (H1)

The subject of section 6.4 below is to explore hypothesis one (H1):

- H1: the influence of investment incentives on the timing, type, location and size of IIS assisted SMEs was limited.

With a view to simplifying the discussion below, H1 was broke down into four nested hypotheses. First,

- on the timing of enterprise start-up (H1.1): the 1990s upsurge in the number of IIS licensed projects or assisted enterprises had very little to do with the provision of the IIS support.

This sub-hypothesis considers, among other things, the relaxed regulatory entry barriers since the beginning of the 1990s but I argue that the IIS neither created nor influenced entrepreneurs who were otherwise reluctant to set up new enterprises. Second,

- on entrepreneurial sector choices (H1.2): for many Ethiopian SMEs founders the choice of a sector was largely dictated by the attributes and resources of the entrepreneurs such as accumulated capital and their experience in the chosen sector.

Consequently, I will argue that the subsidy to activities received by (or for) the entrepreneur would only produce deadweight for the IIS. Third,

- on entrepreneurial location choices (H1.3): IIS barely influenced the location decisions of SME founders.

Here I will demonstrate that, among other things, market, physical infrastructure (like power and roads), institutional structures (such as business information and



banking services), and access to land and premises were key factors for location of many SMEs, whereas the IIS was not. Fourth,

- on the size of an enterprise (H1.4): gain from tax exemptions due to the IIS contributed to the size of the new SMEs and/or provided funds for the purchase of higher capacity machinery.

In this respect, therefore, I argue that at start-up the IIS did encourage the increase in physical capital of some enterprises. Section 6.4 below thoroughly discusses each part of hypothesis one as outlined above.

#### **6.4 The link between enterprise start-up and the IIS**

This section discusses the extent to which IIS influenced entrepreneurs motives and resources (section 6.4.1) and entrepreneurs decisions on the timing of entry, enterprise location, sector and size (section 6.4.2).

##### **6.4.1 The influence of investment incentives on entrepreneurial motives and resources**

**The IIS as entrepreneur motivating factor:** At first inspection of the framework for enterprise start-up (Figure 6.1) the IIS appeared to have less relevance to initiating enterprise idea generation. However, as Semunesh, head of the department for licensing and registration for investment incentives at EIA, explained:

prior to obtaining an investment licence some entrepreneurs visit the authority seeking advice and information on potential areas for investment, the available investment incentives, and the procedures that they go through in order to get an investment licence. (Semunesh Demetros, 1998)

But the consequences of entrepreneurs' visits to the investment licensing agencies (the EIA and regional offices) were not obvious. Were advice and information obtained effectively used and did they influence entrepreneurs' subsequent choices on type, location, and size of an enterprise? Or did the advice and

information from the licensing agencies lead to changes to the entrepreneurs' raw ideas? The extensive evidence I obtained (and documented in chapter five) did not provide strongly affirmative support for either of the above questions.

To begin with, what entrepreneurs received by way of advice from the licensing agencies was technical guidelines on feasibility study of projects. Such advice was not only limited in content, but the technicalities involved were also too complicated for many entrepreneurs to understand. More importantly, the advice provided was less relevant to many entrepreneurs' immediate problems such as obtaining an enterprise site. The head of the Oromia Investment Office unequivocally admitted these limitations when he stated that 'the advice we give to investors is often academic and irrelevant' (Tahir Aman, 1998).

Advice to entrepreneurs was inadequate mainly because, first, the investment offices did not have the required quality and number of people to advise entrepreneurs in their key problem areas. Lack of people who coach entrepreneurs was inherently a national problem as there were barely any agencies (public or private) in the country that were committed to supporting entrepreneurs and enterprises, for example, in the areas of machine/technology choice and import and entrepreneurial skills development.

There were consequences of this lack of support to entrepreneurs as clearly manifested in the macro statistics used in this study. For fear of risk and/or lack of information and guidance, a number of entrepreneurs chose established activities or known products, technologies and markets. In short, the project ideas of a good number of entrepreneurs were duplicates of what others were doing or intended to do. In start-up processes and/or subsequent to start-up some of these entrepreneurs failed to perform satisfactorily as more and more of them were competing in limited markets.



Second, in spite of the fact that the EIA licensing procedures were simple, less bureaucratic and less costly, some entrepreneurs saw EIA procedures as obstructions to the enterprise start-up process. This misconstrued perception of the IIS system was a deterrent to entrepreneurs obtaining the otherwise limited advice and guidance.

As demonstrated from the cases studied and interviews made with the authorities, some entrepreneurs seemed to have followed the investment authority guidelines but only to a degree. With a view to getting the IIS licence, entrepreneurs followed EIA guidance and submitted project documents that identified project objectives, main products and lists of machines and enterprise locations. However, a full cost benefit analysis that took account of, among other things, the IIS benefits was barely made by the entrepreneurs. Consequently, the IIS benefits were hardly considered in the analysis of and decision on features of the new enterprises such as their location and product choice.

The following examples from the case studies illuminate how limited the IIS role was as a motivating force for starting up enterprises. The owner-manager of UE3 has worked for the Ethiopian government and a British company ICI. When ICI pulled out of Ethiopia in late 1980s the job of the current owner-manager of UE3 was at stake:

Three options were available to me: first, working for the same company probably in Britain, second, setting-up and running a similar company in Ethiopia and, third, seeking a job elsewhere in Ethiopia and work for others. As I was heading towards retirement working abroad was not a viable option. Working for others was not an option either since I was in responsible posts for years. .... I therefore decided to set up this enterprise and run it by myself because this job has been what I did in my adult life and will always want to do for the rest of my life. I am trained as an agricultural specialist and I have a wealth of experience in the field. Therefore, the motive for setting-up this



enterprise was to do with my interest, profession and circumstances at the time, notably ICI's withdrawal from Ethiopia. (Markos, 1998)

In the case of UE3 clearly the trigger for the set-up of the UE3 enterprise was the fact that the owner-manager was threatened by the loss of his well paid job. For entrepreneur AE1 too, the fact that his two sons were facing the threat of unemployment was the key trigger for setting up the enterprise. Other entrepreneurs had somewhat different key triggers for setting up their respective businesses (as summarised in Table 6.2). Entrepreneurs of AE2, AE3 and UE2 were motivated by the prospect of making profits. For example, explaining the economic motives (and logic) and entrepreneurial attributes for setting-up AE2 the manager said:

[In the metal sector] a good proportion of Ethiopia's import consisted of processed basic metal which came at a high price. We thought the raw import could be locally processed and more value added to it. Further there was a huge demand for corrugated iron sheet and other roofing materials. As a civil engineer by training [coupled with local and international experience] the principal owner knew a lot about the sector - these reasons led us to set up the enterprise. (Asegid, Acting manager of AE2, 1998)

As for UE1, the owner had run a business in the informal sector for about ten years. But it was the lower regulatory barriers introduced in 1991/92 that motivated him to set up the new enterprise in the formal sector.

**Table 6.2** Key enterprise start up drives

entrepreneur	actual key start-up reason given	classified key trigger
AE1	... provide jobs for my two sons who failed their school leaving examination	threat of unemployment
AE2	... huge demand for corrugated iron sheet and roofing materials	financial motive
AE3	... activities chosen are profitable	financial motive
UE1	... I was receiving constant harassment from the authorities because I was operating in the 'illegitimate' informal sector. Now I wanted to run my business legally	leaving the informal sector
UE2	... increase in earnings and capital	financial motive
UE3	... threat of unemployment	threat of unemployment

*Source: Information supplied by the entrepreneurs*

The point of the foregoing quotes and Table 6.2 is that, although the entrepreneurs gave more than one motive for setting up their respective enterprises, none said that the IIS triggered those motives or even the IIS was associated with one of those motives.

In conclusion, therefore, the IIS to a lesser extent helped entrepreneurs formalise their raw enterprising ideas but it neither provided them with new ideas nor motivated them to change their original ideas. This conclusion, however, does not suggest that if the quality of advice and information were better and/or assisted entrepreneurs understood and made use of them then the IIS would have influenced decisions on features of enterprises. To the contrary, I argue that the IIS, as an instrument of intervention, was too weak to influence entrepreneurs' decisions. The fundamental determinants of the features of many Ethiopian SMEs were other factors like attributes and resources of the entrepreneurs.

**Entrepreneurial resources and the IIS:** Did the IIS contribute to entrepreneurial resources? This, I argue, is an important question because motives and



commitments go with resources of the entrepreneurs. Here my starting point, as reported in Chapter Five, is that many Ethiopian entrepreneurs are 'resource poor'. For investment capital many entrepreneurs depended on traditional sources like past savings, *ikoub*, family and friends and asset sales. For many entrepreneurs it was often difficult to get access to bank loans because, in the first place, they had to possess property like houses to make collateral arrangements. Moreover, entrepreneurs also faced severe land/premises acquisition problems and their enterprising ideas were limited by their risk averse behaviour and poor state of entrepreneurial skills. Did the IIS help in these regards?

There are two ways of looking at the IIS contributions. First, as I will explore further in the next section, the IIS directly contributed to resources by cutting start-up costs and increasing return to activities subsequent to start-up. Secondly, and perhaps more importantly, the IIS helped some entrepreneurs get access to resources like bank credit and a serviced enterprise site (this unique role of the IIS will be the subject of chapter seven). Both these (real or potential) benefits of the IIS largely depended on the initial tangible and intangible resources of the entrepreneurs. At entry into the IIS system (as documented in chapter five) entrepreneurs with a stronger resource base or established life style (possession of a house, for example) could afford to put up collateral arrangements for bank loans and become eligible to enter the IIS system.

What is more, the awareness levels of the IIS support also largely depended on the education level and networking abilities of the entrepreneurs. Relatively better educated entrepreneurs actively sought information and interpreted and used it. For example, these entrepreneurs not only knew about most parts of IIS support in their proposed activity areas but also knew about it at an earlier stage of enterprise idea development. Similarly those who possessed the skills of negotiation with officials (or established some kind of connections) made use of



the IIS to get access to resources. In this regard, therefore, the IIS did not address the unequal pre-IIS entry resources bases of the entrepreneurs that in effect determine the take up rate incentives. Consequently, the IIS entry criteria served more of the elite and better resourced entrepreneurs.

Finally, although important, a strong resource base by itself did not guarantee success. As evidenced from the case SMEs, success at start-up or better performance following start-up were functions of entrepreneurs' skills and commitment. What is more, entrepreneurs' capacity to manage businesses, capture and process information and marketing skills were the essential ingredients for subsequent success. In short, as the evidence from the case studies demonstrated, regardless of the IIS support, entrepreneurs who recognised the internal and external constraints that faced their enterprises and actively developed their staff, sought markets, used installed production capacity, etc. have succeeded in growing their enterprise into a multi-million *birr* business over a short space of time.

#### 6.4.2 The IIS and entrepreneurial decisions on enterprise features: search for causal links

The preceding section showed that the IIS did not feature as an influencing or motivating factor for enterprise start-up idea generation. Moving on, the findings documented in chapter five (Table 5.10) also showed that:

- first, the timing for enterprise start-up for the entrepreneurs that took part in this research was not affected by the IIS,
- second, none of the entrepreneurs interviewed said that their preferred enterprise location had been (would have been) affected by the IIS, and
- third, with regards to activity type and size of operation, one (out of the six entrepreneurs) in each category said that the IIS had (would have had) a marginal effect on their decisions.

In the next section I thoroughly examine why the IIS did not affect entrepreneurs' decisions (when it did not), and the mechanisms by which it did affect entrepreneurs' decisions. As an approach, first, I highlight IIS related outcomes and subsequently discuss the causal factors that accounted for these.

#### 6.4.2.1 Hypothesis H1.1: IIS influence on timing for enterprise start-up

On the timing of enterprise start-up hypothesis H1.1 stated that:

- the 1990s upsurge in the number of IIS licensed projects or assisted enterprises had very little to do with the provision of the IIS support.

I start by examining the facts. Between 1992/93 and 1997/98 the number of entrepreneurs who sought IIS support rose from a mere 542 to 4246 and actual IIS licensed new start-ups, for the same period, increased from 23 to 1163 (chapter five, Table 5.1). These developments were significant showing that, relative to any previous decades, in the 1990s Ethiopia had the fastest increase in enterprise start-ups. To put this in context, in the manufacturing sector alone, by 1997/98 Ethiopia had an all time total of 3373 small to large enterprises. Over 1992-98 there were at least 497 additions of small to large scale manufacturing enterprises that had an IIS licence. This sharp increase in enterprise start-ups over the study period (1992-98) was attributed to the IIS by the investment authorities. As Tesfaye Belay (1998), head of the EIA policy department, concluded 'investment incentives were working and the evidence was that thousands of new start-ups emerged'.

A search for more evidence on the subject of enterprise start up revealed a rather different story. First, some relatively old data (Axe, 1994) showed that up to 44 per cent of all new SMEs start ups were not assisted by the IIS. Secondly, the evidence I compiled in 1998 (see Table 4.2, chapter four) showed that in Addis Ababa only one in three SME start-ups were IIS assisted. What was more significant about the second evidence was that unassisted enterprises were setting up in the same activity types and locations as the assisted ones. These and similar examples



drawn from macro statistics began to suggest that investment incentives did not cause start-up. Below I will argue that while the IIS was a positive development, its impacts were insignificant compared to the impacts of the wider enabling environment on private sector development in general.

What really favoured more enterprise start-ups in the 1990s? Here it is important to take account of some historical developments. To begin with in the early 1990s, particularly following the fall of the Derg, some aspects of the economic, social and political and (also geographic) scenes of Ethiopia changed. For example, Derg's central planning principle of economic management and its socialist ideology were abandoned in 1991 in return for a free market economy and political pluralism. Power was decentralised to regional governments. Furthermore, the economic reform programme that was launched in 1992 opened up opportunities for the private sector to participate in the economy. More specifically at least three developments that have had a direct bearing on the entrepreneurs were

- a couple of paragraphs (contained in the 1992 investment proclamation) opened up a wide range of sectoral activities that used to be in the absolute monopoly of the state.
- the absolute limit imposed on the amount of capital to be deployed in private enterprises was lifted.
- what used to be a 'one person one business' rule was abolished.

The above developments also encouraged some informal sector operators to operate legally, as for example the founder of UE1 did. Moreover, AE1 was set up because owning more than one business was allowed by the change in policy. Encouraged by positive developments on the economic front, in addition to the domestic entrepreneurs, some Ethiopians who lived abroad and foreign nationals too, started doing business in Ethiopia. Owing to different reasons like the economic reform measures and better weather, the economy grew by over six per



cent per year for most parts of the first half of the 1990s (Tambek, 1996). Therefore, it was the combination of all these factors that generated the condition for more enterprise start-ups in the 1990s.

There was more. Some adverse effects of the economic reform programme in some peculiar way helped entrepreneurship. For example, as a consequence of the economic reform programme part of the civil service workforce was made redundant. According to one estimate 80,059 permanently employed members of the civil service (these people, on average, were better educated) were made redundant in the early days of the reform programme alone (MOPED, 1992: 37). Those people who were made redundant had positively affected not only the immediate supply side of the entrepreneurial function but also part of the established entrepreneurial culture and attitude of Ethiopia. As the cases studied showed, some of these retrenched people became 'entrepreneurs', partners and/or senior members of the workforce in the emerging enterprises. Moreover, as common place examples show, entrepreneurs and staff in the growing computing and consultancy industries and private health sector, by and large, were also former government employees. As most skilled personnel who set up these new enterprises were not sufficiently trained and experienced immediately following the reform measures, it is safe to assume that some enterprise start ups were made possible because of transfer of skilled personnel from the public to the private sector. The bigger picture of the consequence of this development was that one of the prevailing social attitudes that placed 'educated people' in the civil service but left business for 'uneducated' or less educated citizens was seriously challenged.

The following evidence from the cases studied clearly corroborates the foregoing discussion. The entrepreneurs I had discussions with favourably upheld the enabling environment for setting-up enterprises with or without the IIS support.

The account given by the manager of AE1 was that '...we started the enterprise because it was only after the mixed economy policy (1990) allowed us to own more than one business'. Similarly the perspective from UE2 (an enterprise that did not receive IIS support) was that:

... change in public policy was important because it has created sufficient demand for us. Since the changes in policy many construction works have started - private buildings, offices, and public institutions such as schools and hospitals. 70 per cent of our demand largely comes from the expanding private sector and the other 30 per cent of demand comes from the public sector. However, investment incentives did not initiate the start-up of this firm - after all we neither sought nor received the support. (Semu, Manager of UE2, 1998)

UE3 also reflected on the broader issues:

... the change in the economic policy has helped us in many ways. In the past (Derg regime) working out the field with peasants required licences, in this regard, therefore, had it not been for the change in the system we would not have been set up. (Markos, Manager of UE3, 1998).

The accounts given by the other entrepreneurs featured in this study were broadly similar. Therefore, as the evidence presented was convincing, this section concludes by saying that entrepreneurial attributes and resources, coupled with a supportive enabling environment, accounted for the increase in new enterprise start-ups in the 1990s. The association between the IIS and enterprise start-ups was simply conjectural but not causal. This conclusion, therefore, supports part of hypothesis one (H1.1): the influence of investment incentives on the timing of enterprise start-up, at best, was small.

#### 6.4.2.2. Hypothesis H1.2: IIS influence on entrepreneurial decision on activity type

In this section I argue that the IIS barely played a role in entrepreneurial choice of activity type. The arguments made here rest on three sets of evidence that emerged from the IIS authorities, case study entrepreneurs and SME theory.

**First, evidence from IIS authorities:** A thorough analysis of interviews given by officials from the Ethiopian Investment Authority (and regional bureaux) provided no evidence to support their claim that the IIS influences entrepreneurial sectoral decisions. The statement by Tahir Aman, head of the Oromia Investment Office, summarises the prevailing view of the authorities on the subject:

we provided assistance to enterprise start-ups in selected areas in the hope that activities in these areas would help increase local resource uses and promote inter -sectoral integration' (Tahir Aman, 1998).

In short the authorities simply granted incentives to entrepreneurs who happened to have chosen 'pioneer' or 'promoted' activity areas.

**Second, evidence from the entrepreneurs:** The following voices from the entrepreneurs engaged in this study clearly showed that the IIS was in fact a docile instrument as it did not influence entrepreneurial choices of industries. None of the entrepreneurs (except for AE2) said that their industry choice was influenced by the investment incentives. Instead the entrepreneurs focused on experience and training in the chosen sectors as the most important factors:

I have had long experience, as a retailer, in the footwear business. However, my sons and I did not have the skills in shoe production but we entered into the business by forming a partnership with a person who was experienced in producing shoes. (Begashaw, Manager of AE1, 1998)

The family ... has been in this business (especially beeswax trading) for a long time. ... [and] most individuals who joined the enterprise too have had long experience in business. So affection for and interest in



the profession and experience were some of the key factors that enabled us to set up the business. (Amare, Manager, AE3, 1998)

I come from a rural area. When I got in Addis Ababa, first, I became an apprentice, then after obtaining some skills, I opened a repair shop which also manufactured products that was not officially licensed. Finally I moved on to set up this enterprises. (Kadir, Manager of UE1, 1998)

I had a strong interest in woodwork right from my childhood. ... following my training in wood manufacturing I set up this enterprise (Semu, Manager of UE2, 1998).

I ... decided to set-up this enterprise and run it by myself because this job has been what I did in my adult life and will always want to do for the rest of my life. I am trained as an agricultural specialist and I have a wealth of experience in the field. (Markos, Manager of UE3, 1998)

Even the one enterprise (AE2) that considered IIS incentives emphasized experience and training as key causes in the decision on industry:

The principal owner and founder of this engineering firm is a civil engineer by training and experience. (Asegid, Acting Manager, AE2, 1998).

As the attributes of all the entrepreneurs discussed in chapter five showed, they had fair knowledge of the products they intended to offer and the knowledge came from own experience and the organisations (mostly public enterprises) they worked for. Therefore, the stories of each entrepreneur clearly demonstrated that their choices of activities very much depended on their previous experience, formal/informal training, interest and passion for an activity (and, as discussed earlier, these were coupled with the presence of market opportunities, ability to form a partnership and the enabling environment).

**Third, support from SMEs theory:** The theory reviewed in chapter two demonstrated that founders often choose a product/sector known to them

through experience, hobby, formal or informal training and/or family tradition. According to some studies referred to, in the small enterprise sector '... the decision as to what to produce is often made before the new entrepreneur has actually decided to set up his own business.' (Binks and Jennings, 1986: 7). Similarly, Fisher (1988: 92) concluded that the choice of product is 'highly predetermined by the work experience and history of the potential new firm founder'.

In conclusion, therefore, the three sources of evidence discussed in this section supported the idea that in the context of many Ethiopian SME founders, the impact of the IIS on their choice of an industry was unimportant. In support of hypothesis H1.2, then, the IIS influence over entrepreneurs' choices of an industry was small.

However, the above conclusion is subject to caveats. First, the empirical evidence from the SMEs studied was limited in that there were no convincing macro statistics that proved or disproved IIS impact on entrepreneurs' choice of industries (except for the interviews made with the authorities). Secondly, the conclusion that emerged here was largely a consequence of the nature of many Ethiopian entrepreneurs. As my discussions from earlier chapters showed in Ethiopia, in most cases, ownership and management of an enterprise were embedded in the founder(s) and hence entrepreneur attributes (like resources and experience) mattered a lot in choosing an industry. In the case of few but relatively larger enterprises ownership and management did not necessarily depend on individual entrepreneurial experience or location of residence. This meant that in the set up of few larger enterprises, entrepreneur related experience perhaps was not as important as in SMEs because founders of larger enterprises could have afforded to buy in required skills and mobilise resources. Therefore,



incentives like the IIS may have played positive roles in setting up relatively larger enterprises in a particular sector (and/or location as discussed below).

#### 6.4.2.3 Hypothesis H1.3: IIS influence on entrepreneurial location decision

According to the authorities (at EIA and Oromia regional office) the IIS was attributed to more new start-ups in the regions outside Addis Ababa and the Addis Ababa-Nazareth corridor. Discussing the situation at regional level, Tahir Aman, head of Oromia investment office, referred to the evidence where the IIS was said to have influenced entrepreneurial location decisions in the Oromia region:

Traditionally entrepreneurs preferred the Debre Zeit-Nazareth corridor for enterprise start-ups - this was in spite of the fact that Burayou and Sendafa corridors had equal access to Addis Ababa. Instead of the Debre-Zeit-Nazareth road, therefore, we provided incentives to entrepreneurs who set up enterprises along the Burayou and Sendafa lines. In recent years, following incentives, enterprises in the food and synthetics sectors were set up along Burayou and Sendafa roads. In addition, more recently 50-60 entrepreneurs moved out of the Addis Ababa administration and came to our region. Entrepreneurs wanted to set up enterprises in Oromia because they were still close enough to Addis Ababa. We believe recent entrepreneur behaviour was primarily to get advantage of the IIS incentives. (Tahir Aman, 1998)

But even Tahir Aman was not confident about the IIS impacts a little further from the capital, Addis Ababa:

Overall, I think, regional impacts of incentives were too small. Incentives alone will not take investment away from places like Addis Ababa. Factors like infrastructure and growing demand in the urban centres were key to location decisions. (Tahir Aman, 1998)

According to the evidence documented in chapter five (section 5.2) in the spatial distribution of enterprises the regions that gained most were those neither 'developed' nor 'least developed' - that is those in the middle like SENNPR and



Tigray. The least developed parts of the country, that cover a vast area including Afar, Benishangul and Gumz, Gambela, Ethiopian Somali Regions barely had any manufacturing enterprise start ups over 1992-98. In spite of being classified as 'most assisted' through the IIS, these least developed areas did not gain a share in the national distribution of manufacturing enterprises. This meant that the IIS did not explain the spatial distribution of manufacturing enterprises.

As discussed in chapter 5, Addis and the corridor enjoy relative advantages of better infrastructure, business agglomeration, market and peace over the rest of the country. In spite of all these favourable factors, the enterprise start up rate in Addis Ababa over the period 1992-98 was low. At the heart of this problem was the land lease price, as high as *birr* 4300/m<sup>2</sup> that limited so many IIS licensed projects from being implemented in Addis Ababa.

At a micro level, entrepreneurs' views support my reinterpretation of the evidence on spatial aspects of new enterprise start-ups. As noted earlier (chapter five, Table 5.11), entrepreneurs' answer to the question whether the IIS influenced their decision on enterprise location was unequivocally 'no'. The following voices illustrate further the reason why the IIS did not influence enterprise location:

I did consider setting-up this factory in Bu-i, my home town [about 100 km south of Addis Ababa]. I discovered that setting-up a shoe factory in Bu-i required buying most of the raw material from Addis Ababa. Not only the workforce had to be hired from Addis Ababa but also moved to and sheltered in Bu-i. Again Bu-i being a small town I had to sell the produce elsewhere, perhaps in Addis Ababa. To save on costs raw material and the produce had to be transported in bulk (i.e. I needed to have bank credit to buy trucks in the first place). I also found that road transport in and out of Bu-i was poor. Supply of power and utilities too would have been major limitations. I also needed storage facilities for raw material and products. In spite of additional investment incentives that I would have received these limitations

stood against setting-up the factory in Bu-i. I therefore decided to stay in Addis Ababa. (Begashaw, Manager of AE1, 1998)

AE2 was typical of others:

... because of its market and infrastructure advantages, with or without the IIS support, the location of this enterprise would have been Addis Ababa. (Asegid, Acting Manager of AE2, 1998)

It is not surprising that entrepreneurs in the manufacturing and service sectors emphasized infrastructure and demand factors for setting-up in Addis Ababa. Those enterprises like AE3 and UE3 which used more agricultural land, however, were willing to operate in regions away from the centre with or without investment incentives. As UE3 manager stated:

I did not require incentives or persuasions to operate in regions (including peripheral regions). I go to places where maize, coffee and cotton grow and I am welcomed. (Markos, Manager of UE3, 1998).

There were other factors taken into account when making location decisions. For example, explaining why they did not consider locations outside Addis Ababa, one of the reasons given by the acting manager of AE2 was that 'law and order fade away as you go out of the capital'. Social and managerial factors too played roles in location decisions especially when operating in more than one site. For example, the UE2 manager said 'as a manager I would prefer to be close to our operation sites. But with my family here in Addis Ababa I cannot operate hundreds of kilometres away in places like Mekele' (Semu, 1998). Moreover, many entrepreneurs who perform roles of management and functional operations like accounts, marketing and repair and maintenance activities were not easily able to operate simultaneously in different sites.

The conclusion that emerged from the macro data and evidence provided by the entrepreneurs was that benefits from the IIS support were too small and short lived to override other location specific benefits. Entrepreneurs' views, therefore,



reinforced the fact that the IIS, as an instrument of influence on entrepreneurial location choices, was hardly important. This conclusion was consistent with that emerging from the literature reviewed in chapter two (especially that based on developing countries). Overall, hypothesis H1.3 was supported: the influence of investment incentives on SMEs founders' location decision was small.

#### 6.4.2.4 Hypothesis H1.4: IIS influence on size of an enterprise

In this section I argue that, however marginally, the IIS positively affected enterprise size. Firstly, as evidenced in chapter five sections 5.2.3 and 5.4.3, by reducing the tax on imported machines the IIS saved as much as 13 per cent of start-up costs on machinery and equipment. These savings, at least for the case SMEs studied like AE1, increased enterprise size by enabling the entrepreneurs to buy higher capacity machines or use the funds to pay for working capital and workforce. Secondly, by exempting entrepreneurs from paying income tax the IIS (potentially) increased return from enterprising activities. Provided these returns were used within the enterprise (for expansion purposes) it was possible that the size of an enterprise increased.

As the evidence that emerged from AE1 showed, the IIS (on occasions) provided incentives to entrepreneurs to increase investment at start-up. I emphasise that such an effect of the IIS was occasional because it directly affected the smallest projects that were initiated with start-up capital close to the cut-off point for support, that is *birr* 250 000<sup>66</sup>. The manager of AE1 who started off with investment capital close to the margin for IIS support said that:

When we approached the investment office we were told that our project should have a minimum of *birr* 250 thousand worth of

---

<sup>66</sup> This observation has implications for many IIS assisted enterprises. As chapter five (section 5.2) showed, IIS licensed projects that were proposed with less than *birr* 500 000 accounted for 64 percent of all licensed projects.



investment in machines as a condition to receive investment incentives. But our investment plan was short of the required minimum. We generated additional capital and revised our project plan upwards to *birr* 250 thousand and consequently the office granted us the incentives. (Begashaw, Manager of AE1, 1998).

However, such positive impacts of the IIS on enterprise size depended on factors including entrepreneurs' ability to raise own funds and/or be able to meet bank collateral requirements. As details of AE1 accounts showed, the manager of AE1 borrowed *birr* 120000 from the bank (by putting his house up for collateral) and imported *birr* 147925 worth of capital goods. The extra *birr* investment, in the end, saved the entrepreneur *birr* 37538 in duties and resulted in a relatively larger size enterprise. In contrast to smaller enterprises like AE1, however, larger enterprises like AE3 did not need to raise their start-up capital to enter the IIS system because their sheer size allowed them to appropriate IIS benefits. From the above discussion, although the evidence was limited, there were clear indications that occasionally the IIS marginally but positively influenced the size of new start-ups. And this confirmed that hypothesis H1.4 held true, that is: gain from tax exemptions due to the IIS contributed to the size of the new SMEs and/or provided funds for the purchase of higher capacity machinery.

#### 6.4.2.5 The IIS impact on the adoption of technology and jobs creation

The preceding section on IIS impact on size of an enterprise largely looked at the investment capital measure of size, and suggested that IIS encouraged the use of capital intensive technique of production. This section describes the process of technology adoption by the case SMEs involved and considers IIS impact on employment.

The entrepreneurs involved in the research showed some similarities in terms of the process of adopting technology (that is from search to actual installation of new machines). For all entrepreneurs (except AE1) technology adoption was an

incremental process. As the entrepreneurs decided to set up an enterprise they had some knowledge of the products they intended to offer like corrugated iron sheet, and they had fair knowledge of the technology used to produce these products. Second, following the decision to set up an enterprise, the entrepreneurs mobilised skilled personnel that were instrumental in the search for and implementing the installation of the new machines.

Third, at the launch of the enterprises, project plans only partially were implemented. This means that operations started on a small scale like using single line operation, and deploying a mixture of imported, local and secondhand technology. Then a brief period of learning the design of products to the satisfaction of the market and Ethiopian standards authorities followed. Moreover, the entrepreneurs also learnt how to run the entire organisation of the enterprises. In the process of learning, problems with the technology deployed were discovered<sup>67</sup>. Finally, after a 'satisfactory' learning process, the entrepreneurs committed to importing the full range of machines and equipment that were planned<sup>68</sup>.

The entrepreneurs studied, however, followed different routes to technology choices. Some entrepreneurs chose to use locally produced tools and machines and others used imported tools and/or machines (or a combination of both). When entrepreneurs chose to use imported capital goods (new or second-hand) they either bought the goods from local dealers or placed direct import orders. The distinction between local purchase of capital goods (including that imported

---

<sup>67</sup> For example, AE2 imported a machine that produced thick corrugated iron sheets (that was above the specification of the domestic standard).

<sup>68</sup> Whether project plans that were granted IIS licences were implemented was the subject of EIA's follow up teams (chapter five). But the full impact of adopting imported technology came at much later data than the official launch of enterprises. Because the tax exemption period starts from the date the enterprise was launched, the gradual process of technology adoption has limited entrepreneurs from using the full benefits of tax exemptions.



by dealers) and placing direct import orders was essential because entrepreneurs benefited from the IIS only when they directly imported capital goods. There were some crucial implications of these options as the examples of AE1 and UE1 shows.

When they started both AE1 and UE1 were about the same size and operated in the same shoe making business. UE1 did not seek government support largely because the owner neither liked approaching some 'corrupt' government bureaucrats nor knew enough about the IIS benefits. UE1 used mostly locally produced (or some imported but locally distributed) capital goods all purchased from local market. AE1 however imported most of the capital goods. By UE1's standards AE1's cutting knives (upper sole and insole) and sewing machines were technically advanced and all were imported partly with a view to benefiting from IIS support.

As the foregoing discussion showed the manager of AE1 made an exceptional effort and borrowed money with a view to importing and benefiting from IIS incentives. Hence, as far as AE1 was concerned the IIS encouraged the owner to directly import capital goods the results of which were that (i) while AE1 benefited from the IIS (a tax saving equal to 25.4 per cent of total imported capital) UE1 paid this full amount in taxes. (ii) AE1 (also other AEs in general) incurred more costs like loss of advisory services at installation, repair and maintenance that they would have received from specialised capital importing local companies. (iii) AE1 (also AE2) made expensive mistakes in the specification of the ordered capital goods which was largely due to lack of experience in importing machines. (iv) businesses of local dealers in imported capital goods were also adversely affected.

In terms of workforce, relative to AE1, UE1 had a more experienced and better paid workforce. The founder of AE1 paid his average 'semi-skilled' worker *birr* 325/month while UE1 paid a similar worker *birr* 560/month. In terms of output



neither produced qualitatively different products, except that AE1 used packaging. These and similar pieces of data suggested that UE1, using mostly locally produced capital goods, gradually moved from specialised craft technology into a factory system whereas AE1 directly entered into a modern factory system. The long term and wider consequences were that enterprises like AE1 tended to use relatively advanced technology which were likely to be labour saving. Most tools (except for a couple of sewing machines) used by UE1 were either mechanical or semi-electrical - which meant that UE1 used energy saving technology. The fact that enterprises like UE1 depend less on electric energy means that, other things being equal, these enterprises are potentially regionally flexible. The implication here was that central IIS objectives like jobs and regional development could be adversely affected by the use of the very instrument of IIS (that is exemption from capital goods import duties). Moreover, by encouraging IIS supported enterprises to import duty free capital goods the government loses revenue that would have been used in other ways such as expanding the poor infrastructure.

Did the IIS encourage the use of capital intensive technology? Referring to the macro statistics, Table 6.3 shows the 1992-98 average investment capital per enterprise and job. Prior to start-up the average size of an IIS licensed project (in terms of capital investment) was *birr* 6.7 million. But as enterprises set up this average size of a project dropped to *birr* 4.8 million. As discussed in Section 5.2, there were several reasons for lower size of investment. First, at start up as entrepreneurs were in the early learning process of using the machines, the full range of machines and equipment were not acquired. Second, the IIS licensed project plans were often overestimated (with a view to getting better access to non-IIS assistance). In terms of permanent jobs the average enterprise size actually increased as IIS supported projects became operational. However, compared to

the planning stage, investment capital per jobs phenomenally increased as enterprises set up, by nearly seven times from *birr* 13930 to *birr* 96110.

**Table 6.3      Investment capital-labour ratios (1992-98).**

Indicators	IIS Licensed Enterprises (plan)	IIS Supported New Start-ups
investment capital/enterprise ('000 <i>birr</i> )	6660	4780
permanent employment/enterprise	48	50
investment capital/employment ratio	13930	96110

*Source:      Information organised from EIA unpublished data.*

Because of a lack of benchmarks I found it very difficult to say whether the above capital to labour ratio or the cost per job was high or low. But, as the above enterprises level technology uses showed, relatively few and large IIS assisted enterprises imported and used capital intensive technology. Finally, note that the total volume of ‘jobs created’ in the IIS assisted enterprises was not entirely new. The evidence from the cases studied showed that some of the entrepreneurs and key members of their staff, notably staff with accumulated knowledge in making the products like the engineers, and lawyers and accountants were former employees of the public sector. In this regard, therefore, the public sector lost twice: first by subsidising capital importing and second by losing its skilled workforce to the private sector. The next section considers broader consequences of the IIS.

**6.5            Evaluating the performance of the IIS**

This section uses some principles and concepts drawn, among other sources, from an OECD document (OECD, 1979) and Bennet and Robson (1999) to assess the success of the IIS support system. According to the OECD document, as incentives constitute a claim on scarce resources, social benefits should be commensurate



with their social costs (OECD, 1979: 13). Bennet and Robson (1999) used levels of use of services of 'business link' as a measure of efficiency benchmark against a 'high' level of 80 per cent set by the British government Department of Trade and Industry. However, apart from using the approaches and concepts, I did not employ the 'business link' take-up rate as a benchmark because as this will not compare like with like. Instead, although dated, I used the available and comparable IIS take-up rate from the 1960s. And, secondly, I also considered whether IIS objectives were achieved and whether direct and indirect outcomes and impacts were produced.

Below two broader performance measures of the IIS were identified. First, IIS outcome measures. These included the number of entrepreneurs who sought and successfully set up enterprises with IIS assistance (with their regional and sector dimensions). Further, I also used the type and level of the IIS support delivered, and the efficiency of the IIS agency itself, for example, in processing applications. The second set of measures focused on IIS impacts that looked into, among others things, the extent to which IIS objectives were met, the amount of revenue foregone and businesses displaced due to the IIS.

#### (i) IIS take-up and utilisation rates

Based on Schwarz *et al*'s (1968) study (reported in chapter three) in the 1960s the utilisation rate of investment incentives in Ethiopia was high, which meant that all IIS licensed projects were implemented (or under construction at the time). And more importantly all projects initiated in the 1960s drew on IIS benefits. But IIS take-up rates in the 1990s showed a different picture. First, as Table 6.4 shows, between 1992-98 a total of 4246 projects were licensed to benefit from the IIS support. Of this total 1163 enterprises (that is 27 per cent) were successful start-ups. EIA sources also showed that of the total IIS licensed projects some 673 (that



is 16 per cent) were under implementation stage. This left 2410 or 57 per cent of the licensed projects that failed to start up enterprises.

**Table 6.4 The efficiency of the IIS take-up (1992-98)**

Major sectors (1)	No. of licensed enterprises (2)	No. of started-up enterprises (3)	IIS Efficiency Rate (2/3 * 100) (4)	Expected permanent Jobs (5)	Estimate of Perm. Jobs Created (6)
Primary	1164	514	44	49038	26796
Secondary	1845	497	27	78311	15536
Tertiary	1237	152	12	75692	15541
Total	4246	1163	27	203041	57873

*Source: EIA (1998) unpublished data and own calculation*

Enterprise start-up rates in the service and manufacturing sectors (where enterprise site and premises have been serious problems) were low, respectively 12 and 27 per cent (column 4). More expected permanent jobs were also lost in all sectors and particularly in the service and manufacturing sectors where project implementation was low. Over 1992-98, of the 203041 expected permanent jobs only an estimated 57883 jobs were created by assisted enterprises (column 5 and 6). As earlier discussions showed, at start-up the average investment in physical capital formation per licensed project dropped from *birr* 6.7 million to *birr* 4.8 million - that was by around 28 per cent.

Second, my findings (chapter five, Table 5.6) showed that, first, of the IIS licensed projects that have successfully started-up about 64 per cent of them did not draw on any kind of IIS benefit. Moreover, the remaining 36 per cent of the enterprises drew on only a part of IIS benefits (mainly exemptions from import duties). This meant that nationwide only around 419 enterprises received some kind of IIS support.

Those enterprises that benefited from duty free import of capital goods made savings of around 13 per cent of the value of imported capital goods. The situation with other types of IIS benefits was even worse. As discussed in chapter three, the IIS codes stipulated support to enterprises, in addition to exemptions from import and income taxes, through tax relief on expenses incurred on research and development, site development, building construction, and machine installations. The evidence obtained from the case studies, and corroborated by the investment authorities, showed that even fewer than 36 per cent of all assisted enterprises drew on exemptions from paying income tax, taxes on research and development and site development. Exemption from paying income tax in particular appeared to be a key instrument of the IIS - but enterprises did not benefit from income tax exemptions owing to the fact that either they did not make profits during the grace period and/or requirements for tax related record keeping were expensive. Furthermore, as evidenced by the case SMEs, entrepreneurs hardly knew about tax relief on other expenses incurred (like on research and development).

(ii) IIS agencies and staff efficiency

The Ethiopian Investment Authority (EIA) is a nationwide institution with structures laid down at the federal, regional and zonal administration levels. As of 1998 the whole structure employed at least 500 skilled personnel and was run with multi-million *birr* administration expenses. What has this huge IIS structure, solely set up to deliver the IIS, achieved?

To its credit the IIS structure performed many functions (some of which were not quantifiable). For example, it served as a promoter, albeit symbolic, of the private sector in general. While I was conducting the field work for this thesis, I also closely observed operations of the structure and found it to be one of the least bureaucratic institutions in the country. One good example of EIA's efficiency was that it was processing most of IIS licence applications within 10 working days - a



practice not common in most other government agencies. Although it is difficult to compare IIS with other similar structures, in terms of measurable criteria I found IIS structure performance short of its potential. The fact that it attracted 4246 projects over six years (around 707 per year), and assisted not 1163 as crude macro statistics suggested, but merely 419 start-ups (that is only 70 per year) suggests that its potential was not fulfilled (however, as chapter seven will show, an IIS licence helped some entrepreneurs in getting subsidised and quicker access to state controlled resources like land and energy sources).

(iii) the extent to which IIS objectives were fulfilled

Regarding the fulfilment of IIS objectives, Tesfaye Belay, head of EIA's policy department said:

Over recent years we have had many enterprise start-ups. This showed that more quality and quantity of output have been produced, more employment has been created and regional development, technology and skill development have been promoted. (Tefaye Belay, 1998)

I have no doubt that relative to earlier decades, Ethiopia had a faster rate of enterprise start-ups in the 1990s. However, the evidence and the arguments I made in the preceding sections consistently show that the IIS barely influenced location and sectoral decisions and the timing of start-up. Consequently, official claims, as in above, were misleading. The fact was that enterprises were setting up with or without the IIS support. The IIS did positively influence the size of some enterprises but at the expense of a large quantity of imported capital goods that, among other things, required the payment of foreign exchange. Overall, there was no evidence to suggest that the IIS effectively promoted its key objectives of influencing entrepreneurs' decisions over the choice of sector and location.

(iv) Economic cost and displacement effects of the IIS



Head of the policy department of EIA, Tesfaye Belay did not doubt that in pursuit of the IIS objectives ‘... those who collect government tax revenue [were] the immediate losers’. He also went on to question that ‘... on balance, would the foregone revenue benefit the enterprises?’ and came up with an interesting conclusion:

Our view is that the foregone revenue was justified because it has created more employment, promoted technology and skill development. It is worth paying the foregone tax now because this will eventually expand the tax base. (Tesfaye Belay, 1998)

The IIS has certainly helped some entrepreneurs develop their project ideas, albeit in a limited way, and offered up to 13 per cent savings on duties from imported machines. Nonetheless, the IIS has incurred a considerable amount of economic cost to the society. Firstly, between 1992 and 1998, from duty tax alone, an estimated amount of *birr* 526 million revenue has been foregone with a view to supporting IIS assisted enterprise start-ups. What the authorities hardly knew was the distributed IIS benefits across sectors, regions and sizes of enterprises. This thesis shows that new start-ups in the service and manufacturing sectors received 42 and 50 per cent the revenue foregone, respectively. In terms of regional distributions of IIS benefits, Addis Ababa and Tigray between them received 93 per cent of the revenue foregone (that is 60 and 33 per cent, respectively). Even within Addis Ababa and Tigray it was a few highly capital intensive projects that benefited from the support. Contrary to the expectations of the policy makers, therefore, most of the IIS benefits were appropriated by entrepreneurs based in the least supported areas like Addis Ababa. Consequently, the impact of the IIS in terms of supporting enterprise start-ups in disadvantaged regions was far from being realised.

Secondly, the IIS has resulted in adverse consequences to some businesses in the distributive trade sector that import and distribute capital goods. As explained

earlier, with a view to taking advantage of import duty exemptions, some IIS licensed entrepreneurs directly imported capital goods - affecting local dealers in capital goods. Moreover, entrepreneurs direct machine/equipment imports meant higher transaction costs (including search costs of sources and prices of machines, and handling imports), delays in the delivery of consignments, and subsequent losses of local advisory support in installing and repairing machines. I have also noted that partly due to these problems, some IIS licensed entrepreneurs (especially those who set-up small enterprises) gave up their duty exemption privileges and purchased machines from local dealers.

Overall, my evaluation of IIS performance in the preceding section, coupled with the conclusions I arrived at in section 6.2, portrayed a rather unsatisfactory view of the impact of the IIS on enterprise start-up and development. In section 6.6 below I provide a brief explanation for the limited IIS contribution to enterprise start-up and development in Ethiopia.

## **6.6 Summary and some explanations for the limited IIS impact on enterprise development**

Why was the IIS performance unsatisfactory? This section addresses this question by considering the immediate IIS related and broader enterprise development problems of Ethiopia.

### **6.6.1 Limitations of the IIS System**

I argue that the main IIS limitation was its flawed assumption about the behaviour of entrepreneurs. Evidence generated for this thesis and other sources<sup>69</sup> showed that many entrepreneurs were low resource based with limited external financing, were risk averse owing to insufficient information and knowledge about opportunities, and had limited managerial and technical skills to run businesses.

---

<sup>69</sup> See Ayalew, 1995, Yohnnes, 1995, Habtamu, 1995, EEA, 1997b, Korten, 1972 as well as chapter 3 Section 3.2.2.4.



Many entrepreneurs also set up sole proprietary enterprises that were less responsive to activity/location based incentives. The fact that over 85 per cent of Ethiopians depend on smallholder farm production and employment was also a clear indicator of how small was the critical mass of entrepreneurs in Ethiopia. To unlock these structural barriers the IIS tried to do many things (more job creation, sector and regional re-allocation of investment, etc.) but with limited means of tax incentives. Tax incentives that were primarily meant to influence entrepreneurs' behaviour failed, among others things, as a consequence of the nature of many entrepreneurs as outlined above. Moreover, many entrepreneurs' sectoral and location choices heavily depended on their accumulated resources, experience, market and infrastructure but not on short-lived and marginal IIS incentives.

The IIS failed to address key enterprise development problems. IIS arbitrary classification of activities as pioneer and promoted has created a negative attitude towards the unassisted activities such as services. While there is no doubt that activities like banks and insurance and hotels are instrumental for the development of the rest of the economy, the authorities supported the production sector at the expense of the services sector. The evidence generated for this thesis challenges the policy stance. I argue that many entrepreneurs with limited enterprise start-up resources like finance and enterprise sites chose to enter the service sector because (a) entry cost was relatively small and (b) the service sector served as a testing ground before entrepreneurs moved on to high capital investment activities. Further, the idea of encouraging larger enterprise start-ups in peripheral regions was ill-thought out as these enterprises required a central market and better infrastructure which were concentrated in the centre. In this regard, therefore, the scheme failed to directly address entrepreneurs and enterprise problems such as poor infrastructure.



The IIS was based on spatial problems that were barely conceptually and empirically established. To begin with the country never had regional income accounting to show regional inequality in development. The argument for the IIS policy was presented as a function of distance from the political centre Addis Ababa, in which locations further away from Addis Ababa were considered disadvantaged in terms of development. But the authorities used selective regional disparity measures such as manufacturing enterprise and road networks distributions that truly favoured Addis Ababa and the Addis Ababa-Nazareth area. However, these selective measures were area-based rather than people-based (for example, a calculation of manufacturing output per person would have resulted in a different index of regional development). But the way I perceive regional development (or lack of it) is that most sector based developments reinforce each other - for example, roads attract manufacturing and energy supply, etc. Because of the IIS emphasis on a centre-periphery dichotomy, there was a clear flaw in the policy. Take districts like North Shoa and South Wollo that are close to Addis Ababa. These districts have been over-populated and the farming population who lived there depended on degraded land for living. Perhaps what was needed in these areas was alternative employment to farming such as manufacturing. But the IIS implicitly discouraged manufacturing in these central locations, while encouraging inaccessible peripheral areas that were less suited for manufacturing development.

IIS performance was also unsatisfactory because it was based on an over-identified single theme enterprise start-up problem. Crucial problems of Ethiopia's enterprise economy such as access to enterprise sites, bank credit and energy sources were undermined by 'the investment problem'. Further, even delivering limited IIS assistance was constrained by entrepreneurs' misguided perception of the scheme - in that some entrepreneurs viewed the scheme as paternalistic to a selected group of people and bureaucratic - and consequently

they distanced themselves from it. Some other entrepreneurs were not fully aware of the IIS assistance owing to, in part, their limited ability to capture, process and use information. But most importantly, I argue that entrepreneurs or their representatives did not take part in the formation of IIS policy and structure and these were not adequately communicated to the targets. Other IIS agency related problems may include shortages of staff to provide advice to entrepreneurs, office equipment and vehicles. But these are small matters compared to some endemic problems of the whole enterprise economy.

#### 6.6.2 Endemic problems of the Ethiopian enterprise economy

For a long time the private sector has been constrained by successive government policies such as regulatory barriers at entry. Most pervasive was the 1970s and 1980s where government took a clear anti-private enterprise stance as these represented an idolatry of personal gains. This has created a misguided anti-private business attitude among sections of the civil service. During the field work I noted that every priority (telephone lines, energy, bank credit, land, etc.) was given to state owned (and affiliated) businesses, not because these were efficiently performing units (creating and maintaining jobs and profits) but because they were 'publicly owned'.

Furthermore, there was still the long established tradition that undermined entrepreneurship. The society still cherishes and grants high profile to warriors but not entrepreneurs, and implicitly promotes win-lose attitudes rather than cooperation. These cultural barriers, coupled with low levels of income, create less opportunity for entrepreneurship and for enterprises to expand. Moreover, the enterprise economy was constrained by national structural problems such as (a) poor physical infrastructure (like power, roads and telephone lines, and water). (b) institutional structures (business information system, promotional services, consultancy and advocacy agencies, institutions for developing technical and



managerial skills, banking, etc.). As it emerges strongly from this thesis, there was a major problem in providing entrepreneurs access to enterprise site and premises. Finally, enterprise start-ups also confronted cumbersome bureaucracy in registration and licensing. This pessimistic but realistic assessment of the performance of the IIS suggests a thorough review of the approaches, policies and institutions of the Ethiopian enterprise economy. This will be the issue that I will consider in chapter eight.

## 6.7 Conclusion

For an entrepreneur to maximise the IIS incentives an enterprise had to be set up in a pioneer sector and in a peripheral region. However, the best location for a particular enterprise, in most cases, did not result in the best IIS support. This chapter showed that sector-location decisions were primarily made for many entrepreneurs by factors like experience and own resources rather than by the IIS. Consequently, many entrepreneurs set up enterprises where they lived, worked, generated experience and resources. The IIS did, however, marginally impact on the size of new start-ups. Nonetheless, the real determinants of enterprise size were the resources of the entrepreneur, social and economic fundamentals in a given location such as market and infrastructure.

The discussion in this chapter also showed that projects of significant size, that is those unlikely to depend on state support, appropriated most of the IIS support. This meant that IIS assistance, in spite of a huge amount of revenue foregone, was very limited. It follows that hypothesis one of the thesis was proved correct: that the influence of investment incentives on the timing, type, location, and size of IIS assisted SMEs was small. Furthermore, this conclusion was consistent with that which emerged from the study of investment incentives in other developing countries.



The fact that IIS role and impact were limited has serious implications for the scheme. Should the government provide essential infrastructure which is likely to produce more enterprise development or keep on providing the largely sterile IIS? In the concluding chapter of the thesis, I will argue for a different perspective to enterprise support initiatives. Next in chapter seven I discuss IIS's unique role of moderating entrepreneurial access to state controlled resources like enterprise sites.

Once again the conclusion of this chapter reminds us of the key points made at the start of chapter one (section 1.2) – that lack of learning from other countries' experiences particularly on SMEs development, and poor integration of the IIS into the holistic industrial, SMEs and regional development contributed to its failure.

## **7. Discussion on the Role of the Investment Incentives Scheme in Enterprise Start-up Resources Mobilisation and Business Legalisation**

### **7.1 Introduction**

The discussion in chapter six showed that the Ethiopian investment incentives scheme (IIS) barely influenced entrepreneurs' decisions over location and industry choice of enterprise start-up. However, on the positive side, chapter six demonstrated that investment incentives helped increase financial gains to the assisted enterprises and positively affected the size of some SMEs at start-up.

This chapter discusses how sometimes the value of the IIS licence was superior to the holder when used, not as a device for tax breaks as intended, but as a moderator of access (or a gateway) to state controlled resources like a serviced enterprise site. Because of the severity of the problem and its significance in enterprise start up, this chapter particularly examines why and how the IIS licence was used as a means of getting cheaper access to state controlled and distributed land. Further, the chapter discusses the nature of economic and non-economic decision making, and the behaviour of politicians, bureaucrats and business interest groups in resource and incentive distributions and enterprise regulations. Second, this chapter also discusses whether the IIS licence eased the bureaucracy involved in the business legalisation process. These two core areas of the chapter provide explanations for hypothesis two (H2)<sup>70</sup>:

- H2: some entrepreneurs sought the support of the IIS, in addition to its fiscal benefits, for its role as a gateway to resources (land, credit and utility) required for enterprise start-up, and to ease the otherwise bureaucratic business legalisation processes.

---

<sup>70</sup> Most of the evidence used in the chapter came from the qualitative and quantitative data set documented in chapter five.

Section 7.2 below provides the background on why and how the IIS licence was used to provide entrepreneurial access to resources and ease the legalisation process. Section 7.2 also offers a summary of the arguments and formal construction of hypothesis two. Based on hypothesis two, sections 7.3 and 7.4 present the discussion on IIS actual benefits derived from its moderating roles to some IIS holders. Finally section 7.5 provides the conclusions of the chapter.

## **7.2 The political economy of state control and distribution of resources**

This section discusses the evolution of state control over key economic resources like land. Moreover, the section shows the roles of different government agencies in resource and incentive allocation and enterprise regulation. Finally, the section explains how a particular business interest group referred to by the government circle as ‘investors’ emerged and influenced the pattern of resource and incentive allocations.

### **7.2.1 Entrepreneurs’ access to resources and enterprise regulation**

#### **7.2.1.1 Background to institutional control over resources**

Because of its great importance to the livelihood of a large segment of the population, access to, cost and use of land produce have been major issues for generations in Ethiopia. Historically land ownership patterns of Ethiopia were diverse, comprising individual or private, kinship, state and church (see, among others, Markakis (1974) and Desalegn (1985)). In the past state and church, in particular, appropriated the surplus generated from land. The state also used land in lieu of salary to pay its civil servants and generate revenue to expand public services. But access to land has been politically derived in the form of a grant for temporary use (known as *gult*), life time use, and hereditary use.

The untenable feudal land relationship and the introduction of commercial farms in the 1960s that caused the economic value of land to soar and threatened the lives of the peasantry provided the background to the 1974 revolution. The



revolutionary Derg government (1974-91) abolished the feudal system of land ownership and brought all rural land under 'the collective property of the Ethiopian people' (PMGE, 1975b). The rural land reform, among other things, limited the size of land allocated to an individual peasant to a maximum of 10 hectares, prohibited the selling, exchange or mortgage of land and the use of hired labour in agriculture.

As reported in chapter three, undertakings like mining, heavy industries, radio and television transmissions, insurance and banking, etc. were also put under the exclusive control of the state (PMGE, 1975a). No person with a permanent job was allowed to licence as a wholesaler, retailer, importer, exporter or service dispenser. No person was allowed to obtain more than one licence nor own more than one business or establish a branch (PMGE, 1975c). For nearly two decades these and similar developments limited the scope of activities available for private sector undertakings.

Following the change in government in 1991 the economic role of the state showed some changes (see details in Befekadu and Berhanu, 2000). Some of the activities that had been in the absolute control of the state were opened up for the private sector. Nationalised enterprises were put up for privatisation and restrictions such as on the amount of capital investment were lifted. In general the state moved more towards providing the 'enabling environment' and incentives for private sector development.

However, reforms undertaken by the Transitional Government of Ethiopia (1991-95) failed to include land in a meaningful way. Consequently, debates over alternative land holding systems focused around three broad alternatives: state control, state control with some limited private ownership and freehold (Desalegn, 1994, Dejene and Teferri, 1995). The Ethiopian Peoples Revolutionary Democratic Front (EPRDF), the party which ruled the transition period and

controlled the political landscape since, came out as a clear opponent to private ownership of land. EPRDF's argument was essentially based on the premise that private ownership of land dispossesses the peasants of land and subsequently leads them to urban unemployment. Subsequently, in the 1995 constitution, land (except for the limited leasing facilities) was retained under the ownership of the state:

The right to ownership of rural and urban land, as well as of all natural resources, is exclusively vested in the State and in the peoples of Ethiopia. Land is a common property ... and shall not be subject to sale or to other means of exchange (The Constitution, article 40.3, FRDE, 1995a).

Furthermore, constitutional power over the acquisition and transfer of land was placed under the regional governments.

In spite of the constitutional arrangement, land issues continued to attract wider debate. Total state control over land has been criticised from different corners including academics, NGOs, international institutions like the World Bank (Desalegn, 1994, and EEA, 1997a). Opposition to state control of land was based on arguments such as the regime's lack of incentives, the state's undue power over allocation, and administrative costs of allocation. Moreover, opponents argued, under state control the two major land holding problems, namely land fragmentation and insecurity, remained unabated. A growing population, coupled with limited means of increasing intensive agriculture, lead to ever diminishing per capita arable land and produce. To add to the problem, the system did not allow access to land use unless peasants permanently lived and worked on the land. This, according to Desalegn 'has trapped an enormous population in the rural areas, creating the conditions for a Malthusian disaster' (EEA, 1997a: 10).

Implementing access to land under the current constitutional arrangement has not been easy either. As Befekadu observed, primarily, the institutional set-up itself was a constraint:

The current [institutional] arrangement which leaves a lot to discretionary power is indeed over-bureaucratized and unnecessarily segmented... Investors are required to acquire licences from the central government and thereafter negotiate on the terms and conditions of acquiring land with the local administrators where the investment is to be located. Acquiring a licence does not automatically guarantee the provision of land since the two come under distinct and independent authorities. (Befekadu, 1994: 38).

Moreover, under the current government, although the private sector has been allowed to take part in the economy, the state remained in control of activities of 'national' and/or 'public interest' like metallurgy and pharmaceutical industries, power and telecommunications, the financial and social sectors. Pressure from agencies like the IMF and the government's own desire to attract more foreign investment, however, have contributed to some piecemeal changes to state monopoly of activities. First, insurance, banking and financial activities were opened to the private sector (FDRE, 1996a). And second, similar changes were also made to activities like telecommunications, health and education sectors (COM, 1998b). The hesitant and piecemeal nature of changes, however, contributed to the build up of expectations over major changes in state control over resources (including land), and hence, delayed investment (Befekadu, 1994).

In conclusion, and in spite of the changes that favoured entrepreneurs, key enterprise start-up resources like land, power, bank credit and foreign exchange were controlled by the state. As of 1998, the implication for entrepreneurs was that these scarce resources were distributed in a bureaucratic way through a single state supply channel making entrepreneurs dependent on state provision of access to these resources. Moreover, to get access to state controlled resources



entrepreneurs had to accept agency distribution rules (including the waiting time).

#### 7.2.1.2 Public agencies and enterprise development

Social and economic ministries (and regional bureaux) of Ethiopia (hereafter referred to as public agencies) control and distribute resources like land and incentives like the IIS and/or regulate the behaviour of enterprises (FDRE, 1995b). For the purpose of this thesis, I studied the functions of the most relevant public agencies to enterprise development (see Box 7.1). From my study it emerged that the official roles and functions of public agencies were often segmented between agencies and hid many of the enterprise development issues, particularly at start-up stages. For example, an entrepreneur went through multiple agencies (and units within agencies) to get access to an enterprise site, energy source, telephone lines, bank credit, etc. The purchase of equipment or leasing enterprise site required rigorous inspection and approval by the relevant bureaucrats. What is more, bureaucrats' approval of a request in one area progressively depended on the outcomes of successive stages. For instance, to extend bank loans the Development Bank of Ethiopia required proof of a land deed agreement between an entrepreneur and the land lease board. And the land lease board/office required an IIS licence as well as other permits such as health and safety from the relevant government departments. The IIS licence, in turn, was obtained after machines and site layout were identified in a project document. This assumed that land would be made available after the licence was obtained. The whole resources mobilisation process has become a vicious circle of chain of events with only a limited chance of breaking the cycle.

### **Box 7.1      Resources and incentives distribution, regulation and controlling powers of public agencies**

This as well as subsequent sections refer to roles of different public agencies in enterprise start-up and growth. With a view to enhancing the subsequent discussion, following Dunleavy (1991), I have grouped the relevant public agencies of all levels (macro, meso and micro) under three broad categories:

**(i) public agencies that produce and distribute outputs/service on mainly a commercial basis and using internally generated resources.** Examples of these agencies are banks and utility companies like the Ethiopian Electric Power Corporation.

**(ii) public regulatory agencies that limit or control enterprise behaviour through licensing, standards and follow-up systems.** All socio-economic ministries, notably the Ministry of Trade and Industry (MTI) are put in this category.

**(iii) agencies that control and transfer resources.** These include, for example, regional government bureaux that control and allocate land and premises, Ministry of Finance (MoF) and the Ethiopian Investment Authority (EIA) that subsidise businesses. Agencies under (ii) and (iii) are mostly financed by central and/or regional governments.

It is important to note that these broader agency categories are simplistic in that it is not always the case that an agency falls under one category. For example, in addition to some regulatory roles most ministries (education, health, agriculture) also produce and distribute services. However, the institutional processes of enterprise start-up is better understood when the allocation and regulatory powers of agencies (and their objectives, functions and performance criteria) are known. For instance, owing to differences in objectives the MoF and EIA do not necessarily give similar priority support to enterprises. MoF's main objective is raising public revenue while EIA is entrusted with providing incentives (including fiscal incentives) to enterprises.

It is also important to note sources of agency power (including that given by law). Agency power may emerge from the nature of resources administered. Whether a resource is scarce and/or vital in the enterprise start-up process is crucial. Whether a particular resource is owned and distributed in a monopolistic way is also important. For example, unlike bank credit that can be overcome by traditional means of mobilising finance, land and energy sources are too essential and scarce for start-up. These resources are provided only through the channels of public agencies and access to these resources may take a long time.



Both resources mobilisation and business legalisation, at every agency and layer of government, involved a long process of providing and verifying proof that had to pass at least two tests. These tests, that were conceptualised following Schaffer and Wen-Hsien (1985), were, first, the eligibility criterion (the admission rule to obtain incentives and/or get access to resources). And, second, the rule of ordering applications (which may be called line rules). The 'line rules' deserve more explanation. Entrepreneurs' applications (for a licence or enterprise site) may or may not be filed in the order of the application. As I will demonstrate, within public agencies, and through the influences of quasi-legal and illegal means, altering the order of applications was a common practice. Simple principles like 'first come first served' were regularly violated enabling some entrepreneurs to jump queues for key enterprise start-up resources. It was under these quasi-legal and illegal circumstances that the IIS licence had become an effective instrument for breaking the vicious circle of resources mobilisation process.

Business interest groups too, as I will discuss below, influenced the procedures for resource and incentive distribution.

#### 7.2.2 Business interest groups, enterprise start-up strategies and instruments

State control over resources, notably land, created deep divisions between politicians and within the business community. Consequently, in the early 1990s many competing groups for political and economic power were set up by politicians and business people. Between 1991-94 alone over 60 business associations that largely either supported or opposed government policies were set up (Borin *et al*, 1994). Typical examples of business associations that fell in the opposite camps were the Ethiopian Private Industries Association (EPIA) and the Addis Ababa Private Industries Association (AAPIA). EPIA promoted unreserved property rights (including freehold of land) and a limit on the expansion of party



owned enterprises (Berhane Mewa, 1998). However, the AAPIA fully supported the policies of the current government (Amare Wodajo, 1998). As some key Ethiopian scholars noted (for example, Befekadu, 1994), the intensity of division over government policy created uncertainty over how and when these issues would be settled, and the likely outcome. Consequently, many business intentions, as Befekadu argued, failed to materialise largely because of policy uncertainty (Befekadu, 1994: 37).

The interesting development that followed the reintroduction of the IIS in 1992 was that while those opposed to government policies took the political route to getting access to resources/services, hundreds of entrepreneurs received the IIS licence and created an identity set known as 'investors'<sup>71</sup>. The fact that some entrepreneurs came forward was taken as a sign of success for the government. But for many entrepreneurs there was barely any alternative source of key resources/services like land and energy sources outside the government sector. Investors (or entrepreneurs), therefore, started lobbying for government access to resources. The EIA in particular stood by its clients, the 'investors', and lobbied other agencies on their behalf for support in mobilising start-up resources. Subsequently, the government took account of the influence of investors' interest and devised legal means for supporting them:

The Government may grant freely or without public tendering urban land which is to be utilized for investment that the government encourages or for social service establishments or other purposes which directly benefit the public. (TGE, 1993)

However, the mechanisms for making land available were not put in place until after the passing of the constitution in 1995. In the meantime, using the inadequate legal provisions as some argued, a small fraction of the entrepreneurs that were

---

<sup>71</sup> An investor, in the Ethiopian context, means entrepreneur (see Box 3.2, chapter three).

most loyal to the regime (the roots of loyalty being based on party and ethnic associations) were given privileged access to resources. A good example of this was reported in Hammond (1994) where EPRDF owned company, Hiwot Mechanisation Company, was granted 7000 hectares of land for no more than *birr* 20/hectare for 20 years in the Humara area.

By mid 1990s the political system became stable (for example a new constitution was introduced and elections recognised by the West were held). With the stability of the political system benefits given to few entrepreneurs also became increasingly attractive, which led to more and more entrepreneurs seeking the IIS support and better access to resources controlled and distributed through public agencies. Moreover, entrepreneurs (supported by agencies like the EIA) continued lobbying the government for even better access to resources. The chairman of the Addis Ababa Private Industries Association (AAPIA), explained to me:

We believe the government supports businesses [such as through incentives] to generate employment and increase the welfare of its people. We support these objectives and work with the government to see its policies work. But with parts of the policies like the investment capital ceiling that discriminated against our members that own small businesses or problem of access to land we request the government to make the necessary changes. (Amare Wodajo, 1998)

Indeed these gentle pressures and those that came from the opposition groups subsequently bore fruit and led to more legal provisions:

Whenever [the investment board] deems it necessary, it shall decide on new or additional incentives, other than what is provided under the Investment Regulations (FDRE, 1998b).

Implementation of the provisions of 'new or additional incentives' was conditional on 'exceptional circumstances', never clearly articulated. The vagueness of criteria over free or subsidised access to resources like land has left power at the discretion of politicians and bureaucrats. As the managers



interviewed for this study explained even when policies were favourable to the business community, implementation was slowed by bureaucracy.

Implementation guidelines have rarely been transparent. 'Guidelines are locked in drawers and only revealed upon request ... and guidelines change so quickly and it is not easy to keep up to speed with the changes' (Markos, Manager of UE3, 1998).

Overall allocation of state controlled resources followed patterns. EIA and the regional investment offices supported some entrepreneurs that held IIS licences by way of writing letters of support, making direct contacts like paying visits and/or phone calls to officials in charge of agencies that control or produce enterprise start-up resources. Politicians too influenced entrepreneurial access to resources. As I will demonstrate, often these influences were in proportion to entrepreneurs' closeness to the politicians. At times entrepreneurial access to resources was in exchange for entrepreneurs promoting 'the interest of the public' like regional equity. There were also circumstances where the IIS licence was over-used to get privileged access to resources such as by using networks of friends, former school/work mates, family connections. The political and ethnic cards were important too particularly within the context of the new ethnic/language based structure of government. As this chapter demonstrates, the other aid to access to resources was simple corruption where some entrepreneurs unashamedly gave and bureaucrats and politicians received bribes.

### 7.2.3 Summary and an outline of Hypothesis Two (H2)

The foregoing discussion highlighted that entrepreneurs faced access problems to resources owing to bureaucratic rules of resource distribution. It was also suggested, but yet to be proved, that some entrepreneurs used the IIS licence to ease the problem of access to resources. The discussion also suggested two broader routes that entrepreneurs take to mobilise one or more of state controlled



enterprise start-up resources. Route one was that taken by agency assisted enterprise (AEs) start-ups, and route two was taken by those enterprises that set up without agency support (UEs). Route two involves going through onerous and costly resource mobilising and business legalisation processes. In addition to its fiscal benefits, it was in this context that the IIS licence and structure were believed to have overcome enterprise start up barriers, as postulated in hypothesis two:

- H2: some entrepreneurs sought the support of the IIS, in addition to its fiscal benefits, for its role as a gateway to resources (land, credit and utility) required for enterprise start-up, and to ease the otherwise bureaucratic business legalisation processes.

Entrepreneurs who positively perceived the screening process for investment incentives and passed the eligibility criteria entered into the IIS system. Upon receiving an IIS licence projects became assisted enterprises (AEs). For some AEs the IIS licence, along with other institutional support like letters of cooperation, served as an instrument for skewing application orders for resources in AEs' favour. The IIS licence also made holders look more credible before agency officials like bank managers. It is important to note that not all AEs received privileged access to all resources. There were some AEs whose IIS benefit was limited to exemptions from relevant tax payments. Most of these latter group of entrepreneurs were less resourceful (such as in lobbying skills to influence politicians and bureaucrats) and/or they preferred to operate on a strictly legal basis. These entrepreneurs, like the UEs, took slow and agonising steps to get access to resources.

Unassisted enterprises (UEs) were unassisted by the IIS not because they failed the eligibility criteria, but because the entrepreneurs disliked the bureaucratic and often 'corrupt' procedures of the support system. It was also the case that some of them knew little about the IIS specific assistance. UEs (and some AEs too), as I will

demonstrate in the next section, started up enterprises by employing strategies like 'buying' state owned premises or land and/or operating in semi-legal way in their backyards. What is more, some entrepreneurs may have operated in the informal sector and/or simply remained inert and hoped for such time when access to resources would be made easier.

Based on the foregoing background, sections 7.3 and 7.4 below discuss hypothesis two (H2). For convenience, however, H2 will be discussed in two parts. In section 7.3, I discuss IIS's role as a gateway to resources (land, credit and utility) required for enterprise start-up. And in section 7.4, I exploring IIS's role in easing the otherwise bureaucratic business legalisation processes.

### **7.3 The role of the IIS in enterprise start-up resource mobilisation**

The findings of this study (chapter five) showed that enterprise start-up in Ethiopia faced critical barriers like access to and cost of enterprise site, and shortages of investment capital. Moreover, the acquisition of land or other state controlled resources faced onerous bureaucracy and corruption. In this section I discuss how entrepreneurs involved in this study overcame access barriers to enterprise start-up resources. Further drawing on the evidence from the case studies, interviews with the IIS authorities and macro statistics, I will verify whether public agencies did provide preferential access to IIS licence holders as predicted in hypothesis two. Finally, I will also thoroughly look at the nature and scope of the actual benefits, including enterprise start-up time saved, that entrepreneurs received. Section 7.3.1 begins the discussion by considering entrepreneurial problems and strategies for mobilising resources.

#### **7.3.1 Problems of and strategies for mobilising enterprise start-up resources**

##### **7.3.1.1 AEs and UEs approaches to resources mobilisation**

With a view to looking at the nature of entrepreneurs coping strategies and hence assess the role of the IIS, three of the major constraints to enterprise start-ups,

namely shortages of enterprise site and premises, machines and finance are given in Table 7.1. Cross-case coping strategies that I labelled as internal and external and formal and informal are also summarised in Table 7.1.

First, clarification of the labels used. In this presentation, if an entrepreneur has bought and/or leased resources from public and/or private agencies with an explicit application of legal procedures the strategy pursued would be referred to as formal and external. However, if an entrepreneur used internally generated resources and/or resources were mobilised without an explicit application of the legal process then the strategy would be referred to as internal and/or informal. Second, the information in Table 7.1 shows AEs' tendency to use more of the formal and external means to resource acquisition. The EIA and banks supported AEs' machine import and financial requirements. Land Lease Offices too provided support to the AEs. By contrast the UEs' approach to resources mobilisation was to use more of the internal and informal arrangements. Some of the UEs bought (through illegal arrangements) access rights to public property and/or land by paying what was locally known as *ye'kulf waga* (or literally 'payment for the door key'). In some cases UEs also started operation in their backyards.



**Table 7.1      Some enterprise start-up constraints and patterns of coping strategies**

<b>Enterprise start-up constraints</b>	<b>Coping Strategies</b>	<b>nature of strategy</b>
enterprise site and premises	AE1 - rented public premises	formal/external
	AE1 - used own backyard for production and storage	internal
	AE2 - granted enterprise site, rented public premises	formal/external
	AE3 - leased enterprise site	formal/external
	UE1 - 'bought' access right to <i>kebele</i> premises	informal/external
	UE1 - leased land	formal/external
	UE2 - used own land and premises	internal
	UE2 - 'bought' access right to public premises	informal/external
	UE3 - rented public premises	formal/external
	UE3 - bought enterprise site	informal/external
equipment and machines	AE1 and AE3- imported machines	reliance on EIA
	AE2 - imported & local purchase of salvaged machines	reliance on EIA
	UE1 and UE3 - purchased machines locally	no reliance on EIA
	UE2 - local purchase and import	no reliance on EIA
finance	All AEs - bank credit and own savings	external/internal sources
	All UEs - own savings and informal sources	internal and informal means

*Source:      Organised from interviews made with the entrepreneurs*

Why did AEs, unlike UEs, adopt strategies that provided them formal and external support? I will argue that one key difference between AEs and UEs in resource mobilisation was the use of the IIS licence as the following examples demonstrate. But for brevity the examples focus only on land acquisition.

The owners of AE3 needed an IIS licence to get both tax exemption and quicker acquisition of land. An application (accompanied by the IIS licence) was made to the Addis Ababa City Administration and subsequently land was made available, on a lease basis, to the AE3 only 'a few months' after the application. Similarly AE2 used the IIS licence to get access to land and was granted a freehold of 1800m<sup>2</sup> of land. Acting manager of AE2 conceded that the company managed to get a freehold privilege because 'the entrepreneur had connections to people in government that really mattered'.

AE1 applied for 1800m<sup>2</sup> land on the assumption that it would be granted free of charge. However, owing to changed circumstances, AE1 dropped the application for land:

I made an application at the Addis Ababa City Administration for an enterprise site... Along with my application I attached my industry licence and later my IIS licence. I was in a queue for over three and half years. But when the lease policy was introduced in 1993 I gave up the idea of acquiring land because I could not have afforded to pay for the lease price. (Begashaw, Manager of AE1, 1998)

The size of land requested would have cost AE1 an estimated *birr* 0.5 million. Nonetheless, AE1 used the IIS licence to support his application to get bank loans and foreign exchange to import machines.

In contrast, and in spite of the fact that as a matter of policy land was controlled by the state, UEs were not put off from setting up enterprises. UE2 started the business on 2500m<sup>2</sup> piece of land inherited from the family. However, when the business quickly grew around 10 000m<sup>2</sup> land was required. But the manager explained that:

... owing to the lease policy I was required to raise *birr* 3 million in two years. I was in fact allowed to pay the lease value in instalments but the interest payment would have been too high. Moreover, I needed to develop the area that is pay for supply of power, telephone, water,

roads, etc. which would have cost even more money. In the end I abandoned the idea of leasing government land.... [instead] *I paid money to a tenant of a public property and transferred the tenancy right to me.* (Semu, Manager of UE2, 1998) [italics added]

UE2 declined to use the IIS system in the first place on the grounds that the requirements for support were thought to be excessively bureaucratic. Moreover, machine purchase from local dealers was quicker and payments were made on an instalment basis without exacerbating immediate cash flow problems. Similar to UE2, both UE1 and UE3 used some informal arrangements for getting access to premises and/or enterprise sites by paying money or *ye'kulf waga*.

To sum up, clearly the six entrepreneurs used different strategies (legitimate or otherwise) to mobilise start-up resources. The AEs that took part in this study consistently used their IIS licence to support their case for purchasing and/or getting access to resources needed in the enterprise start-up process. These cases I studied were by no means exceptions. As I will show in the subsequent sections, in Addis Ababa alone dozens of new start-ups that had IIS licences were given free/subsidised land and/or quicker access to land. However, UEs' access to state controlled resources was tougher and cost more (including in terms of transaction cost). UEs, therefore, used more of the informal/internal strategies to mobilise resources.

#### 7.3.1.2 Verifying institutional support to some AEs

In support of hypothesis two, institutional support to some AEs from the EIA, regional investment offices and/or agencies that control resources can easily be verified.

First, consider the institution that granted investment incentives (and licences thereof). In addition to sector/location based tax incentives, the Ethiopian Investment Authority (EIA) and the regional investment offices provided support to the IIS licence holders. The justification was that:



...the key enterprise start-up problems were overall weaknesses in making land and utilities available to the entrepreneurs. We [EIA] helped entrepreneurs by writing letters of cooperation to sectoral ministries and utility companies that control resources and services. (Semunesh Demetros, 1998).

EIA authorities also believed that an IIS licence had more advantages than providing mere investment incentives. In this regard Tilahun, head of a department at EIA, told me that the presentation of EIA letters of cooperation to agency officials controlling resources/services 'created the impression that investors' projects were viable and the investors themselves were committed to the implementation of the projects' (Tilahun, 1998). Further, during my field work I also found that key members of EIA (and the regional offices) sit on committees like that of the land lease and influence the distribution of resources in favour of the IIS licence holders. Tahir Aman:

In the Oromia Investment Office we facilitate the land acquisitions process to investors. For example, I am the secretary of the Investment Board for Oromia that looks into and approves investors' requests for land. I, along with other members of the committee, helped investors to get access to land shortly after receiving licences for investment incentives. (Tahir Aman, 1998).

The privileges stipulated to investors in the Amhara Regional Government investment policy document (AIO, 1997: 20) was even more comprehensive. The policy document stated that following some 'considerations' regarding the nature of particular projects that qualified for the IIS support, land may be granted freely and/or without auction, and access to power, telephones and roads would be on a priority basis. Responses to land requests by investors shall be made in 60 days and other government departments were also required to help investors.

Second, the Addis Ababa Land Lease Office (LLO): Generally the Addis Ababa LLO, due to its onerous bureaucracy and huge backlog of demand for enterprise

site, was the most inaccessible agency to entrepreneurs. Nonetheless the LLO and other relevant departments, as reported in chapter five, explicitly supported IIS licence holders:

We [in the lease office] gave priority to licensed projects for investment. In the lease board, representatives from the utility companies and urban works and development bureau, EIA, all worked in favour of these prioritised investment projects.' (Fikre Buta, 1998).

There was a similar preferential support to IIS licence holders even before auction based land leasing started. As the story went, the lease policy was proclaimed in 1993, but its auction based leasing did not start until some time in 1995. Between 1993-95, therefore, entrepreneurial access to land was on the basis of a waiting list. According to information I obtained from the LLO some 'objective' and 'subjective' criteria were used to skew the order of applications in favour of some investors. Consequently, regardless of application dates or entrepreneurs' level of preparedness on starting projects land was made available to those who (i) produced projects with higher investment capital and job opportunities, and (ii) had an IIS licence (mainly in the productive sector).

**Third, the Ethiopian Electric Power Corporation (EEPCO):** As discussed in chapter five, most EEPCO customers waited in queues, but power connection to IIS licensed enterprises was processed on application.

To sum up, therefore, the foregoing voices of entrepreneurs and government officials clearly demonstrated that some IIS licence holders did get preferential access to resources. Besides agencies 'willingness' to assist, some IIS licensed entrepreneurs used their own inherent qualities to generate external benefits (resources) other than that intended in the IIS. Some of the features of the entrepreneurs that helped most to mobilise resources were better financial position, knowledge of government policies and bureaucracy and connections with politicians. The consequences of lack of access to non-IIS licence holders,



however, meant that enterprise start-ups were made costly, starved of the necessary resources and sometimes failed to materialise. In particular smaller enterprises that had lesser resources (for example lobbying skills) were the losers. If public policy picks up the very few better off and the winners, the question then how can entrepreneurship and enterprise development genuinely be assisted? In chapter eight I will address this and other issues. The next section thoroughly examines the actual financial benefits derived from institutional backing of the IIS assisted enterprises.

### 7.3.2 Actual benefits from moderating roles of the IIS licence

On the part of the government, providing access to resources, notably land, has been riddled with dilemmas: free versus lease holding, auction versus non-auction leasing, spatial factors in land valuation and transfer of property rights. Before I look at the actual IIS licence moderated benefits, especially as it relates to land, in the following section I will discuss the dilemmas over access to land.

#### 7.3.2.1 The dilemma over access to urban and rural land

Following the introduction of the land lease policy in 1993, in both rural and urban Ethiopia, land prices have been increasing. The increase in land prices has been attributed (including by the entrepreneurs involved in this study) to the current state ownership and lease prices. I argue that this was only partly true. In the first place attributing the increase in land prices to state ownership of land was not completely correct. As the theory of land economics shows (Harvey, 1996), one explanation for the increase in land lease prices could be that 'land uses determine land values'. This is because land, unlike other factors of production, has unique features in that the natural space (save reclaimed water bodies) is fixed in supply. In the 1990s, therefore, the increase in economic activities and competition between users such as government, enterprises and households caused land prices to rise. Second, the concentration of complementary services



like power and roads, negative factors like congestion or the fact that open land was available in a hot and disease-ridden area also affected the value of land. However, this is not to say that the form of ownership of land did not affect supply flexibility and hence price. Owing to the static state of land reallocation, land supply (relatively speaking) was inelastic up until the early 1990s.

As shown above, some entrepreneurs were given free or subsidised access to land on a discretionary basis. The argument behind this was that free or subsidised access to land increases the capacity to invest in other forms of capital formation. However, this argument failed to satisfy the critics who, among other things, opposed the state's undue power over land allocation and the administration cost of allocation. What was more, the government's stance on land ownership and subsidised redistribution was in contradiction with another of its own laws. For example, the land lease law (TGE, 1993) was enacted on the basis that inadequate infrastructure was attributed to low level of public revenues which, in turn, was due to the absence and/or low land use fees.

Among other agencies, councils of regional states that were empowered to oversee land acquisition and transfer strongly debated whether land should be allocated on free and/or lease bases<sup>72</sup>. One eloquently argued rationale for land lease was in an Amhara regional government document (AIO, 1995). The argument stated that, first, being a key means of production land should be given monetary value. However, such monetary valuation, the document stressed, should not be in the form of selling and buying because land was owned by the state. Second, although individuals may improve or add fixtures to it, 'pure land' is a natural wealth that should not belong to any individual. If the contribution of

---

<sup>72</sup> Peasants and pastoralists have been given constitutional rights (article 4/5) to obtain land without payment. Similarly in major cities land is freely given to cooperative societies (whose members are of low income groups) that build their own dwelling houses.

'pure land' is left to individuals, the argument went, it gives an unfair advantage to users. Hence, the document concluded, 'everyone has to pay a fair price for land' through a lease system. Following similar reasons elsewhere in the country, auction and non-auction based land lease systems were put in action since 1995. And the duration of the lease, 60 to 99 years, varied between activity types.

As I found out in both auction and non-auction land lease systems determining the value of the lease was a complicated matter. In theory in an auction-based land lease the price was determined by the auction, reflecting the essential qualities of a particular piece of land. But unless the minimum expected level of revenue was generated, officials rejected bids. In the non-auction system the government directly fixed prices. The basis for such direct land lease price fixation, especially in rural Ethiopia, was reckoned on the basis of the proportion that land contributed to output. However, there was no easy and uniform way of calculating land contribution to total output. This was because land productivity varied due to labour and technology employed as well as other factors like weather, geography and management. Determining all these variables across the country, if at all possible, required a large cadastral survey of land. Such procedures of land valuation, as it was applied in the Amhara region, were seriously hampering the pace of land being made available to entrepreneurs.

In some areas where land was occupied by peasants there was a trend (see chapter five, section 5.5) that some peasants, with the knowledge of the authorities, passed on their tenancy rights to entrepreneurs in exchange for money. In other words peasants were selling state property. Without official justification for the practice, a peasant sells the land that he/she was granted the use of it by government regulation. Would such an individual peasant retire, become self-employed, or move to the nearby towns, which the government tried to prevent? These were unanswered questions.



Overall, as the findings of this study showed there were several reasons for the low performance of the auction system. Firstly, as some of the interviewees argued, partly because land auction was a new practice to the country, there were only a few bidders at one particular time. But it was also obvious that the low number of bidders was mainly due to financial and non financial factors that limited people to their immediate area. Moreover advertised plots were often not to the liking of entrepreneurs (notably in terms of size, location and time of availability). Secondly, an auction was expensive to entrepreneurs, in that bidding increased the land price. Thirdly, in central places of Addis Ababa where complementary services were relatively better, the scarcity of unused land put prices up. Overall, procedures for providing access to land were cumbersome and land valuation principles unsatisfactory. In the long run, unless the procedures for access to land are made easier and clear, and its cost reconsidered enterprise development in Ethiopia will remain severely constrained.

The discussion in section 7.3.1 showed that the IIS licence provided entrepreneurial access to one or more resources like land owned and allocated by the state. The next sections show the magnitude of entrepreneurial savings from privileged access to enterprise sites, bank credit and energy sources.

#### 7.3.2.2 Entrepreneurial benefits from agency access to urban and rural lands

In the earlier sections I claimed that the IIS licence provided access not only to the cases studied but also to dozens of entrepreneurs from all over the country<sup>73</sup>. In support of my assertion, below I will discuss entrepreneurial savings from privileged access to enterprise sites at two stages: macro and enterprise levels.

First the macro picture: With a view to showing the magnitude of possible savings, data that showed information on total enterprise start-up and land costs

---

<sup>73</sup> Hammond (1994) also provides more evidence and discussion on this subject.



were summarised in Table 7.2 (see details in chapter five, section 5.5). The data covered 63 and 80 enterprise start-up projects that took place in the 1990s from the Addis Ababa region and rest of Ethiopia, respectively.

Table 7.2 shows that average enterprise start-up cost was lower in the rest of Ethiopia than the Addis Ababa region. This was because in Addis Ababa a larger proportion of investment was in manufacturing and hotels that required huge spending on machines and equipment. But nonetheless, unlike Addis Ababa, in the rest of Ethiopia the average land cost per agricultural enterprise was about 19 per cent of all enterprise start-up cost. This was a reflection of the importance of land in production in rural Ethiopia. In Addis Ababa the average cost of land in total enterprise start-up cost accounted for 18 per cent.

As reported in chapter five, hundreds of IIS licensed applications for enterprise sites (including some in Addis Ababa) were speedily processed and granted free or subsidised access. For example, in Addis Ababa as recently as 1997-98 33 new start-up projects were granted land at 65-100 per cent of its market value free of charge. The significance of Table 7.2 is, therefore, when the IIS licence provided free or subsidised access to land, the benefits, in proportion to total enterprise start up cost were as high as 18 and 19 per cent in Addis Ababa and the rest of Ethiopia respectively.

**Table 7.2** Cost of enterprise site in Addis Ababa and rest of Ethiopia

pointers	Addis Ababa	Rest of Ethiopia
Number of enterprises	63	80
Total start up cost/enterprise ( <i>birr</i> '000)	16580	11147
of which land cost/enterprise ( <i>birr</i> '000)	2985	2146
Land cost/total start up cost	18%	19%

*Sources: Unpublished EIA data (1998), Addis Ababa Land Lease Office (1998) and own calculation*

As chapter five showed, clearly there were variations in cost between and within urban and rural Ethiopia. In the urban context, overall land lease value depended on whether a particular site was serviced with the required level of infrastructure like roads and electric power. In the outskirts of Addis Ababa the average land price per m<sup>2</sup> was *birr* 392, while in the centre of Addis Ababa land per m<sup>2</sup> cost up to *birr* 4300. However, in most smaller towns land prices were as low as *birr* 5/m<sup>2</sup>. With regards to agricultural land, the highest was in Oromia (*birr* 150/ha) whereas only *birr* 65 and 20 per hectare was paid in Amhara and Tigray respectively<sup>74</sup>.

**Second micro level:** Evidence from the cases studied showed that AE2 made savings to the tune of *birr* 0.5 million because the entrepreneur was granted 1800m<sup>2</sup> land free of charge. AE3 acquired 1909m<sup>2</sup> land on a lease basis in a 'few months', compared to years of waiting for many non-IIS licence holding entrepreneurs. Such savings from free/subsidised and quicker access to land, as the macro figures in Table 7.2 showed, were not isolated cases. However, entrepreneurs who did not go by the identity of 'investors' barely benefited from the differential allocation of land. These were 'businesses' including real estate development, offices and shops, supermarkets, hotels and many small enterprises. These group of businesses paid the highest lease price in the country, and were also largely excluded from the IIS direct fiscal support. The anomaly of such a policy was that these businesses created both direct and indirect jobs (as those supported by IIS) and wealth. What is more, businesses like hotels, banks and insurance were strongly linked to tourism and other major sectors of the economy.

---

<sup>74</sup> Another important note was that owing to the cost of land lease entrepreneurs did not enter into the maximum period allowed for lease agreement (i.e. 60 to 99 years). Accordingly, the evidence showed that in Amhara and Tigray land was generally leased for around 20 years and in Oromia leasing up to 45 years was common.



### 7.3.2.2 Benefits emerging from agency access to non-land resources and services

In addition to enterprise sites, owing to shortages or cumbersome procedures of access, entrepreneurs faced difficulties in acquiring services like bank credit, energy, telephone lines, sanitary water, etc. Like land all these services were under state monopoly. For brevity this section looks at entrepreneurial access problems to bank credit and energy sources.

**First, Development Bank of Ethiopia (DBE):** As part of the requirement for extending credit the DBE asked for an IIS licence and entrepreneurs also provided the licences on the assumption that it makes processes shorter. The IIS licence, according to DBE, was used to make a socio-economic appraisal of the proposed project. Nonetheless, as the evidence from the case studies showed the IIS licence was still used to get quicker access to foreign exchange for imports of machinery. And more importantly, the IIS licence made the entrepreneurs more credible before the bank managers and disproportionately helped them to get bank credit (Tilahun, 1998).

**Second, the Ethiopian Electric Power Corporation (EEPCO):** At EEPCO power supply procedures favoured IIS assisted entrepreneurs as they were provided power upon request (often within a month). Non-IIS licence holders, however, were rationed power on the basis of a first-come-first-served principle which, on average, took 3-4 months of waiting before getting power.

Notwithstanding the fact that IIS licence holders had privileged access, energy shortage was a major national problem. The information obtained showed that in 1998 only 13 percent of the population and 421 out of over 600 urban centres were supplied with electric power. According to an engineer at EEPCO, '...every small increase in demand added tremendous pressure on EEPCO capacity. At its [1998] capacity, EEPCO was in no position to meet all demands for energy' (Alemu Egisso, 1998). The other energy related problem was price rises in connection with



the recent liberalisation programme. However, in spite of higher energy prices users (domestic as well as business) were willing to pay for all access costs such as the cost of putting up electric poles, wires and labour.

A recent IIS code allowed private sector participation in the energy and banking sectors. Accordingly, as discussed in chapter three, as of 1997 at least five private banks were set up. However, in the energy sector as of 1998 no private investment had come forward. Owing to its central role in the economy, energy production ought to have received more support (perhaps in excess of the IIS) from the investment authorities. I argue that government's effort in redistributing the pattern of enterprise start-up is only helped if basic infrastructural services like energy sources are made available particularly in less developed parts of the country.

In the next section I consider the role IIS licence played in reducing the time required to mobilise and distribute state owned enterprise start-up resources.

### 7.3.3 IIS moderating impact on the pace of enterprise start-up

#### 7.3.3.1 Treating time as an enterprise support outcome

The literature on the dynamics of the creation, growth, survival and exit of firms (for example, Jovanovic (1982), Nafzinger and Terrell (1996), McPherson (1995) and Mead and Liedholm (1998)) put forward explanations like entrepreneur and firm attributes, location and sector as key determinants of success or failure. However, there is barely any literature on the dynamics of intended and realised enterprise start-ups. Here following research methods in education and psychology (as in Willett and Singer, 1991) I look at time as an outcome of the IIS support. I also argue that treating time is important because a better understanding of enterprise start-up pace (that is through identification of constraints to start-up) helps to design a better enterprise support system.

The question, therefore, was how long it took for an enterprise to set up? It was difficult to address such questions because answers always depended on factors like attributes of entrepreneurs, firms or the political environment. However, here I will consider time as an outcome variable only indirectly. Consequently, the alternative question would be how long did it take to acquire land, credit, or obtain connection to power supply?

As has been said all along, in Ethiopia enterprise start-up faced institutional controls over access to resources and excessive bureaucracy. The view of a senior IIS official supported this:

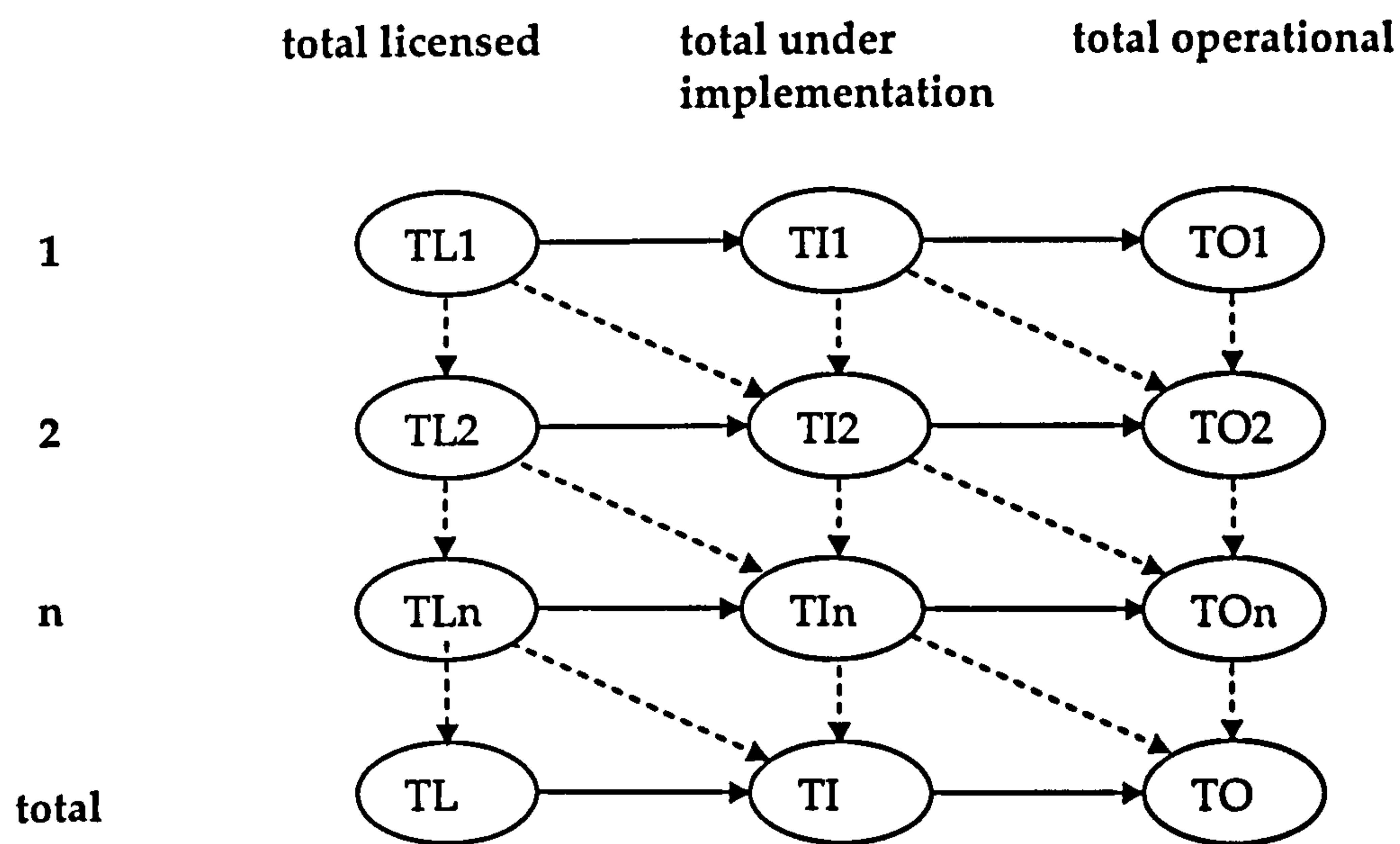
Land may be allocated on lease or freehold basis but if that comes after three years of waiting it hardly constitutes an incentive. Bureaucratic efficiency is the key issue here. The best incentive to Ethiopian entrepreneurs is to provide them with an efficient bureaucracy. (Tahir Aman, 1998).

With a view to mapping out the long institutional processes of resource mobilisation Figure 7.1 is used. Figure 7.1 shows the dynamics of enterprise start-up through stages (as those discussed in chapter six): idea generation, project planning and receiving an IIS licence, project implementation and commencing operation. Hence, in Figure 7.1 columns 2-4 are stages of enterprise start-up that show the total project that received the IIS licence (TL), the total projects that went under implementation (TI) and total projects that successfully completed or became operational (TO). Further, in Fig. 7.1, column one shows period and cohort, where a period is one Ethiopian fiscal year (July-June), and projects that received an IIS licence in one fiscal year make up one cohort.

In period one projects that received the IIS licence may have, first, committed themselves to implement projects (and became TI1) or, second, successfully set-up and became (TO1). Third, it was also possible that a project that received an IIS licence in period one may have joined period/cohort two to become TL2, TI2 and

TO2 respectively. Projects that dropped out of their cohorts and joined the subsequent cohort(s) are shown by dashed vertical and diagonal lines that show movements between cohorts. Rows show cohorts (indicated by solid lines) that start (and perhaps finish) within the same cohort/period. Overall, therefore, total successfully complete and operating enterprises (TO) were those coming from different cohorts: TL<sub>n</sub>, TL<sub>n-r</sub>, TI<sub>n</sub> and TI<sub>n-r</sub> [where n and r referred to cohorts as periods; and r = n-1].

**Figure 7.1** An analysis of the dynamics of enterprise start-up through cohorts



My theory here is that by and large, some IIS licensed projects and UEs that did not receive sufficient public agency support to get access to key resources dropped out of their cohorts. Translating this model into actual data (see Table 5.1 in chapter five) meant that between 1992-98 there were a total of 4246 licensed projects (TL), 673 projects under implementation (TI) and 1163 completed projects (TO). The point here is that some projects may have taken from one to seven years to complete the start-up process. Moreover, evidence also showed that a good number of IIS licensed projects (around 2410 of them) were inert, that is never



initiated enterprise start-up. Based on the foregoing model, below I will show estimates of entrepreneurial time saved due to the IIS.

### 7.3.3.2 IIS role in cutting lead time for enterprise start-up

Within the institutional context predictors of duration of enterprise start-up pace may include the time required to place import orders and the efficiency of importing agencies/processes, time that passes to acquire a site, bank credit and utilities like power. Table 7.3 gives some of the lead time estimates for the mobilisation of key resources .

According to the evidence I obtained from the agencies involved, making land available (at least in theory) took two months for AEs. Only a few UEs got access to land and premises and when that happened it came after long waiting and/or higher lease price. EEPCO extended power supply to AEs immediately on demand. UEs got power supply at a minimum of 3-4 months following applications. Gulilat (1994) reported that machine import took up to 6 months (it took AE1 4 months to import machines). As machine import was in part a function of access to foreign exchange, and relative to UEs, AEs had quicker access to foreign exchange. Consequently, I will argue that, the average lead time for machine import by UEs was greater than that of AEs.

**Table 7.3      Lead times for enterprise start-up<sup>75</sup>**

activity	institution	Assisted Enterprises	Unassisted Enterprises
acquiring land	Regional Govt.	2 months	> a year
machine import	EIA/Customs Auth.	6 months	> 6 months
credit	DBE/CBE	4 months	> 4 months
electric power	EEPCO	1 month	3-4 month

*Source:      Data organised from agencies involved*

However, being a holder of an IIS licence did not always save time for an entrepreneur. For example, AE2 started at a much smaller capacity than planned in 1994 but it took three more years to complete the project according to the original plan. According to the acting manager, as a consequence of a mistake made in ordering, time and money were wasted in reordering machines. There was a shortage of money to import all the machines required to complete the project. UE2, with a view to overcoming these same problems, purchased machines from local dealers. Moreover, according UE2 manager, about four months of start-up time was saved by not applying for the IIS licence and subsequently foreign exchange for machine imports.

This section highlighted that time is a vital resource to the entrepreneurs, and can be wasted due to slow distribution of state controlled resources. The discussion showed that for many unassisted entrepreneurs the pace of start-up was made unnecessarily longer. As I stated in hypothesis two (H2), the discussion so far proved that the IIS licence, in addition to its fiscal benefits, performed two key roles: it assisted some entrepreneurs to get access to state controlled resources like enterprise site and reduced the average time required to mobilise such resources. However, H2 also referred to the IIS licence easing the 'bureaucracy involved in

---

<sup>75</sup>      Lead time is based on the assumption that UEi/AEi pursue similar strategies to resources mobilisation.

business legalisation'. Hence section 7.4 below specifically looks at whether the IIS has achieved this.

#### 7.4 The role of the IIS in reducing the business legalisation process

The discussion in this section begins by outlining the business legalisation procedures and then looks at the IIS role in this regard.

##### 7.4.1 Business registration and licensing

Business registration and licensing were conducted following the commercial code of Ethiopia (IGE, 1960). First, as a demonstration of intent, businesses register at the Ministry of Trade and Industry or other delegated public agencies prior to starting operation and/or trading. Business registration procedures depend on the rules governing forms of business organisations such as sole trader and limited company. For example, micro-businesses that set up with less than *birr* 5000 capital were not required to register (COM, 1997b). But a private limited company (in addition to other legal requirements) was required to submit to the authorities (a) memorandum and article of association, (b) publication of a notice (to third parties) about the formation of a business in a national newspaper. (c) if a business had operated in a region other than its origin then it should also register with the Ministry of Justice.

Second, to commence production and/or trading a business was required to obtain a business licence from Ministry of Trade and Industry or delegated agencies. Obtaining a business licence, in addition to being on the business register, in some instances required a 'certificate of competence' to run a business from the pertinent government institution (COM, 1997a). Third, between business registration and licensing, trade name registration was the other requirement to be fulfilled .



### 7.4.2 Benefits and costs of business legalisation

The main thrust of business registration and licensing (as stipulated in FDRE, 1997) was making businesses legal. Legal businesses are beneficial to the government, firstly, as sources of short and long term revenues (that is from registration and licence fees and business taxes). Secondly, legalisation creates and encourages lawful activities including adherence to public health and safety, labour standards and environmental regulations. Thirdly, registration and licensing enables the creation of databases on businesses that can be used, among other things, for the analysis and design of support for businesses themselves.

These positive aspects of business legalisation resulted in some costs to the entrepreneurs. First, depending on the form of business organisation and capital employed, entrepreneurs paid registration and legalisation fees that constituted a few hundred *birr* (Table 7.4)<sup>76</sup>.

**Table 7.4 Business registration and licence fees**

activity	estimated fees ( <i>birr</i> )
commercial registration	5 (to 105)
temporary business licence	200
permanent business licence	25 (to 225)
trade name registration	5 (to 105)
IIS licence (AEs only)	200

*Source:* FDRE (1997) and COM (1997a).

Second, and more importantly, entrepreneurs incurred transaction costs in an effort to produce evidence of entrepreneurial competence in their chosen business activity. Agencies that perform business licensing required 'specific professional

---

<sup>76</sup> Table 7.4 did not show all business registration and licensing fees. For example, fees for licence renewal, summary registration, registration of commercial representation, publication of legal notices, etc. were not included. Further, application forms for each type of registration or licence cost *birr* 2. Also note that figures in brackets referred to minimum and maximum fees which were based on the amount of paid up capital.

qualification or certification of competence'. The purpose of this requirement was preventing damage to public health and the national economy (such as environmental protection) (FDRE, 1997).

The institutional cost of business licensing was even more costly when viewed within the context of the new devolved government structure of Ethiopia. Federal, regional states and local level government structures all competed for and replicated the processes of business legalisation. The problem for a new business that operated within and outside the region of its origin was that it underwent similar legalisation processes over and over again. The experience of the manager of UE3 was a good example:

Recently we lost three cropping seasons simply to get an operating licence in Nazareth, Oromia Regional State. We bought premises from Nazareth Municipality Office and recruited staff to run the branch. In spite of the fact that we have had a federal business licence, representatives of the bureaux of agriculture, health and trade and industry would not allow us to operate without prior registration and obtaining an operation licence from them. For the officials the fact that we dealt with chemicals made us a public health risk business. But the truth of the matter was that officials were tough on us simply because we were legal and professional operators. Trade in food grains were not subject to such tough controls. Nor were people who sold chemicals and drugs, as side businesses, along with sugar and flour. (Markos, Manager of UE3, 1998)

Businesses, as the UE3 manager explained, were not against regulations but over-regulations that came even before the business took off. As agencies at all levels become registrars and licensing bodies the business community was left with very little time to work on the actual implementation of projects. An estimate showed that entrepreneurs passed more than 40 steps within and between agencies. And the whole legalisation process on average took 3-6 months (Taye Berhanu, 1995:

253). All this time, money and effort were prices that business in the formal sector paid (and these were in addition to competition from the informal sector).

Longer processes of registration and licensing also encouraged corruption. The experience of AE1 manager was telling:

My problem was getting a business operating licence. The legalisation process put me in the hands of some corrupt individuals in the then Addis Ababa municipality office. In order to get the licence the usual procedures like safety and sanitary conditions were checked by the relevant units. I satisfied all the requirements with some difficulty including unnecessary delays and paying bribes on three occasions. However, the main difficulty came later when my documents were deliberately held back by a lower level official who asked for a huge sum of money in return for passing the documents to the Ministry of Industry for the licensing process to take effect. I was unhappy about it and refused to pay any bribe. In between some three months passed. Eventually the excuse for the bribe changed. This time I was told to start the clearance all over again because the earlier clearance happened to be in the previous calendar year. Unwillingly I paid what was demanded but it constituted *toor*<sup>77</sup>. ... you cannot even complain about this matter because the chances of proving your innocence were slim. Corrupt officials operate in some kind of networks and if you complain about them they will make sure that your business is ruined. (Begashaw, 1998).

AE1 manager believed that staff and officials in public agencies did not appreciate what he was trying to do for himself, family and community. It was also the view of other entrepreneurs that some bureaucrats saw entrepreneurs as greedy and their efforts as unworthy. Those, however, that conversed in terms of public policy, whatever their motives may be, were given priority.

---

<sup>77</sup> Wrongdoing - which, according to traditional belief eventually harms the offender in a backlash.



AE1's experience, however, was not an isolated case. Corruption was a widespread practice (*Reporter*, 1998). Some bureaucrats considered their services to entrepreneurs as favours, not as fulfilling their duties required by the law. Bureaucrats received 'incentives' for performing legal duties like leasing land, issuing licences, or exempting investors from taxes. Entrepreneurs too paid 'incentives' to get services that they were entitled to by right. According to the newspaper *Reporter*, up to 10 per cent of some bank loans were appropriated by corrupt officials for facilitating the loans. Such prevalence of corruption was known to the government but until recently the legal system was weak in addressing it. Recently, however, the government started penalising corrupt officials (for example, by a minimum of 15 years imprisonment) (*Addis Tribune*, March 20, 1998). The erosion of faith in traditional Ethiopian values like *toor* also made corruption worse.

#### 7.4.3 IIS and business legalisation: the role of One Stop Shop (OSS) facilities

Did the IIS ease business legalisation processes? In 1996 EIA, in addition to the standard fiscal incentives, started delivering a service referred to as a one-stop-shop (OSS) (FDRE, 1996a). The OSS, offered only to AEs, was essentially an institutional mechanism to deliver existing (but dispersed) business registration and licensing processes (as outlined above) in a centralised manner. As I was 'piloting' my field work, Semunesh, head of a department at EIA, told me that since the set-up of the OSS some entrepreneurs used the facility and avoided all the bureaucratic processes of business legalisation. I followed up this piece of information and was convinced that when entrepreneurs sought the IIS support they also looked for the OSS services. However, in my subsequent fieldwork I discovered that it was only a handful of AEs and foreign owned companies that benefited from the OSS services. For these few AEs the OSS service helped in processing registration, operating licences and work permits for expatriate employees and hence saved time and money.

As far as the link between IIS licence and OSS benefits was concerned, therefore, there was very little evidence from case SMEs to report on and discuss. These entrepreneurs would have liked easier business legalisation processes but none of them benefited from OSS services. The fact that the OSS service started in 1996 (after the cases studied started full operation) was of no consequence for the missing link between the IIS-OSS relationship as suggested in part of hypothesis two 'some entrepreneurs sought the support of the IIS... to ease the otherwise bureaucratic business legalisation processes'.

Many entrepreneurs who sought the IIS support would have neither known nor anticipated that the IIS licence (through the OSS service) eased the bureaucratic business legalisation processes. Between 1992-98 over 4246 entrepreneurs (or start-up projects) received an IIS licence, 63 per cent of which received licences before the set-up of the OSS service in 1996. The rate at which entrepreneurs received IIS licences, on average 707 per year, did not show a particular increase following the introduction of the OSS service either. In fact a record number of 987 entrepreneurs received IIS licences in 1995 before the OSS was introduced.

Furthermore, in 1996 there was a new business registration and licensing procedure in the making. Hence regions like Oromia did not rush to introduce OSS but waited for the enactment of the new law. The new registration and licensing procedure (similar in content to the OSS services) was enacted in 1997 and its implementation and supervision powers were given to the Ministry of Trade and Industry (MTI). Consequently, since 1997, the bulk of business registration and legalisation (for both AEs and UEs) has been run by the MTI and the bureaux of trade and industry. It was obvious that the MTI and bureaux of trade and industry were entirely separate from the institutions that deliver IIS support to businesses. It can, therefore, be concluded that there was no systematic link between seeking the IIS support and the introduction of the OSS services.

Consequently, the hypothesis that 'some entrepreneurs sought the support of the IIS... to ease the otherwise bureaucratic business legalisation processes' was not supported by the evidence.

But, even in 1997/98, why were operations of the IIS/OSS limited? As I found out there were several difficulties associated with IIS/OSS. Firstly, relinquishing regional and sectoral powers over business legalisation to the OSS institution has become a political issue. For example, the Addis Ababa regional government (at least while this fieldwork was in process in 1998) was not willing to transfer the business legalisation procedure to the EIA (hence OSS). The main issue was the conflict between the objectives of raising revenue and promoting investment. In the view of Addis Ababa regional government the EIA was undermining its revenue sources by offering fiscal incentives and subsidising resources like land to businesses.

Secondly, the OSS set-up was over-centralised in Addis Ababa and/or a few regional capitals. Entrepreneurs (for example, from remote coffee growing zones like Gimbi) had to travel hundreds of kilometres to Addis Ababa and fulfil (shop for) all business licensing requirements. Thirdly, OSS services were narrowly conceptualised to cover only the business legalisation process. At least services like providing potential information for business start-ups should have been part of the OSS functions.

Finally it was important to note that there was a minority of people that would lose out if transparent and streamlined bureaucracy (as in OSS) was put in place. In the long business registration and licensing process, entrepreneurs and bureaucrats come face to face at several stages. According to Tahir Aman (1998) some of these entrepreneurs and bureaucrats were not keen on the very concept of the OSS. Even when easier legal avenues were open, Tahir argued, it was in the



interest of some of these entrepreneurs to conduct business informally, including through offering bribes to officials and securing unfair advantages.

**Conclusion on IIS moderating role on resource mobilisation:** Originally the IIS was meant to provide support to enterprises (at start-up and early growth stages) by way of exemptions from paying duties and income taxes. The discussion in this chapter convincingly showed that sometimes the value of the IIS licence was superior to the holder when used, not as it was intended to serve as a device for tax breaks, but as a moderator of access to state controlled resources like a serviced enterprise site. Based on the evidence from case SMEs, Table 7.5 summarises these intended and unintended benefits of the IIS. As chapter six showed, although not all new start-up enterprises benefited, some enterprises did receive the intended IIS benefits as those given in Table 7.5.

**Table 7.5      Summary of intended and moderated benefits of the IIS**

enterprise	intended IIS Roles and Benefits (H1)	IIS Moderated Benefits (H2)
AE1	... exemptions from paying duties, ... the feeling of being supported like advice on project feasibility study	... access to loans and foreign exchange
AE2	... exemptions from paying duties, ... the feeling of being supported	... access to land and utilities (especially power and water)
AE3	... exemption from paying duties	... support in land acquisition

*Source:      Organised from interviews made with the entrepreneurs*

A more grounded exploration of enterprise start-up processes and the IIS system led to the enquiry into an additional relationship (other than fiscal incentives) between the IIS and IIS assisted enterprise start-ups and proved that some entrepreneurs sought the support of the IIS, in addition to the fiscal incentives, for its role as a gateway to resources (land, credit and utility) required for enterprise start-up.

AEs involved in this study (and many other AEs) received these additional supports. As this chapter demonstrated some IIS licence holders, with the backing of institutions, politicians and bureaucrats, were allowed to have a special (subsidised and/or quicker) access to state owned resources/services like land. More importantly, the value of these IIS moderated additional benefits, when appropriated, were superior to the intended fiscal incentives of the IIS. As I consistently showed, from IIS fiscal incentives (from tax duties alone) some entrepreneurs saved up to 13 per cent of the start-up cost of machinery. But free access to an enterprise site alone, on average, saved an entrepreneur about 18 per cent of all start-up costs of an enterprise in Addis Ababa. Therefore, hypothesis two held but with minor proviso that, as I originally expected, IIS did not ease the bureaucracy for business legalisation.

## 7.5 Conclusion

Earlier chapters clearly showed that the IIS was originally meant to increase 'modern' industry. It was further developed to help with indigenisation and SMEs start ups. Now this chapter demonstrated that the IIS license was used to relax state rules over the allocation of scarce resources like land. Consequently, some AEs got those resources at cheaper prices and quicker than UEs. However, there was barely any evidence to confirm that the IIS licence actually helped to ease the business legalisation process through the OSS services. This was because (i) the IIS and OSS services, except in limited instances, come under independent agencies and (ii) the short time that OSS services were put in action.

The chapter also looked into how economic and non-economic decision making by politicians and entrepreneurs influenced enterprise start-ups. The discussion showed that in many instances entrepreneurs' access to state controlled resources like land was made in exchange for promoting some 'public interest' and/or recognition of the legitimacy of the system. Moreover, using the fluid nature of



property right over land and the vague distribution guidelines, some rent-seeking behaviour was observed, for example, some corrupt bureaucrats received bribes. The consequences of these exchanges were that entrepreneurs who were not likely to influence politicians and bureaucrats (like owners of smaller enterprises) lost out.

Many issues also emerged from the foregoing discussion: that, firstly, access to and cost of land has become the main bottleneck to enterprise development in the country. This meant that potential incentives to enterprise start-up and growth lie in addressing constraints like access to land and making land available using transparent and consistent criteria.

Secondly, owing to the land lease system, exit from business has become as prohibitive as entry into business. Transferring privately developed land also requires the new entrant to get into a new lease deal with the government. But there were no clear provisions as to how to handle the property (buildings and premises) of the exiting entrepreneur. Consequently, some entrepreneurs found themselves tied up in their first lease deal and business indefinitely.

The discussion in this chapter also showed the contradiction between short-run and long term objectives, as in revenue foregone today versus investment created for tomorrow. In this regard agencies like EIA that distribute investment incentives and the land lease boards of regional governments sometimes worked in opposite directions. Particularly in Addis Ababa, motivated by higher revenues, the land lease board put up land lease prices at the expense of deterring enterprise start-ups. The next, and concluding chapter of the thesis, looks at such bigger issues that emerged from the discussions in the thesis.



## 8. Thesis Summary, Conclusion and Recommendations

### 8.1 Introduction

Ethiopia was a pioneer in 1950s Africa in the use of investment incentives to attract FDI in 'modern' industry and hence technology transfer. It was also a pioneer in promoting its indigenous enterprises in the early 1960s. However, it used the same investment incentives for this as it had for attracting FDI and technology transfer. When the IIS was reintroduced in the early 1990s, first, it failed to address problems of SMEs such as entrepreneurship development. It also failed to learn from other countries' experiences on local and SMEs development. As in the previous decades Ethiopian policy makers provided local enterprises and foreign investors with the same old investment incentives (that came in the form of exemptions from the payment of import duties and income taxes). The core objectives of these incentives were to encourage enterprise start-up and growth in selected industries and locations.

There were two major reasons for undertaking this thesis. First, very little was known about the rationales for and consequences of investment incentives on enterprise start-up and growth in Ethiopia. Second, investment incentives as an idea of enterprise support initiative was a contested concept. That is, unlike in some developed countries, the theory and practice on investment incentives did not favour the use of these instruments in developing countries like Ethiopia.

These concerns, among others, led to the formulation of two hypotheses. First, it was proposed that owing to the social and economic constraints to setting up enterprises in Ethiopia, the influence of investment incentives on the timing, type, location and size of IIS assisted SMEs was limited. Second, based on grounded exploration of the functions of the IIS, it was hypothesised that some SME founders sought the support of the IIS, in addition to its fiscal incentives, for its role as gateway to state controlled and allocated resources like enterprise sites and

bank credit. Moreover, the research raised questions about the link between enterprise start-up (and early growth) and IIS support.

Answers to the key research questions and the exploration of the hypotheses were based on wide ranging sources of evidence. Macro statistics on 4246 IIS licensed projects over the period 1992-98 were used. Moreover, new evidence was generated from a follow up in-depth investigation of six case study SMEs, and extensive interviews made with senior enterprise policy makers in Ethiopia. As a methodological device, the thesis explored possible influences of the IIS on the process of enterprise start-up by identifying stages of enterprise idea generation, physical construction of projects and commencing operation. The thesis also drew on theories that showed strengths of SMEs (such as in job creation) and provided the rationales for agency intervention, and different segments of the disciplines of economics and social psychology that underpinned the complex factors that motivate entrepreneurs to start up SMEs and influence their choices of industry, location and size of enterprise. The rest of this chapter presents a summary of the findings, conclusion and recommendations of the thesis.

## **8.2 Summary of major findings of the thesis**

The rationales for investment incentives: The IIS had several objectives including using and maintaining natural resources, creating more jobs and promoting a balanced development of regions. However, the thesis found that the rationales behind these objectives were neither explicitly articulated nor had adequate means of implementation. The IIS objectives also suggested ambiguous outcomes. The dimensions of enterprises (industry, location and size) that the thesis investigated were supported by limited tax incentives. Therefore, from the start, investment incentives did not promise significant impacts on enterprise start up and growth.



New evidence generated for the thesis showed that, among other things, the IIS was meant to enhance the sustainability of resource use, promote enterprise competition, strengthen linkages and spillover effects across locations and activities, and protect and encourage indigenous enterprise development. Some of these reasons for investment incentives, especially those referring to sustainability, resource use and competition, add to the theoretical literature reviewed in chapter two.

**Answers to the questions and exploration of hypotheses of the thesis.** Although it lacked adequate means of implementation, the IIS was meant to influence the timing of enterprise start up and entrepreneurs' decisions over the choices of location, activity type and size of enterprise. Following hypothesis one, the evidence and discussions made in the thesis showed that:

*First, IIS had hardly any impact on the timing of enterprise start-up.*

There were more enterprise start ups in the 1990s. But there was hardly any evidence to suggest that there was a causal relationship (except conjectural) between the IIS and the increase in enterprise start up over 1992-98. The evidence says it all: over 1992-98 there were 4642 IIS licensed projects, of which 1163 (27 per cent) started up. Of the actual start ups only 419 (about 10 per cent of total IIS licensed) drew on the benefits from IIS assistance. Most importantly, as discussed below, those that drew on IIS assistance were large scale projects that hardly needed incentives to start up.

The thesis found at a macro level that real factors that contributed to the increase in enterprise start-up were the cessation of the civil war in 1991 and the subsequent introduction of a better environment for the private sector. Moreover, some adverse effects of the adjustment programme conducted during this period (like retrenchment) forced some members of the former civil service to become 'entrepreneurs' and set up enterprises. In short, enterprise level triggers for



founding SMEs (as evidenced from the case studies) were factors like threat of losing employment and/or presence of opportunities for starting up an enterprise, but not the provision of investment incentives.

*Second, there was barely any evidence of IIS's influence over entrepreneurs' decisions on the choices of location and activity type of the new SMEs.*

Based on macro statistics and enterprise level evidence, the thesis found that for many SME founders, formal/informal training, accumulated experience and interest in the chosen sector, the threat of unemployment and market opportunities were some of the factors that provoked start-up in a particular activity type. At the national and regional levels the incentives were granted simply because the entrepreneurs happened to have chosen activities that the authorities preferred to encourage through the IIS. Moreover, over 1992-98 the scheme appeared to have contributed to a small shift in the traditional spatial pattern of enterprises, creating relatively more enterprises outside the dominant region Addis Ababa. However, new evidence that this research generated showed that central locations like Addis Ababa relatively lost share in the spatial pattern of enterprises due to at least the following reasons:

- lack of access to and/or exceptionally high cost of enterprise sites in Addis Ababa deterred enterprise start-up. And,
- relative to Addis Ababa some other regions performed better but not due to the IIS. Regions that were ravaged by internal conflict like Tigray hugely benefited from the cessation of civil war since the early 1990s and created a better environment and more confidence for enterprise start-up.

The evidence documented in the thesis also showed that a vast area of the country that was meant to be most assisted through the IIS did not gain from IIS benefits and hence did not improve its share in the national distribution of enterprises (especially manufacturing enterprises).

Finally, although the generalisation was limited to the cases studied, the accounts of the entrepreneurs demonstrated that the IIS did not influence their location decisions because IIS location benefits were too small to compensate for costs like loss of central market and better infrastructure.

*Third, the IIS did have a marginal influence over the size of an enterprise.*

This study found that the IIS positively contributed to the financial resources of the entrepreneurs that marginally influenced enterprise size at start-up. This influence was created in two ways, first, duty exemptions from importing capital goods increased savings to the entrepreneurs by about 13 per cent of the total cost of machinery. And second, with a view to meeting IIS entry criteria, some entrepreneurs that intended to set up relatively small enterprises increased their start-up capital. But the downside of this, in terms of maximising job creation, was that IIS assisted enterprises adopted relatively advanced technology that did save labour.

Overall, based on the foregoing conclusions, hypothesis one (H1) was confirmed: the influence of investment incentives on the timing, type, location and size of IIS assisted SME was limited. Moreover, this conclusion was broadly consistent with that which emerged from studies on the impacts of investment incentives in developing countries.

*Fourth, the IIS mediated access to resources and eased the bureaucratic procedures thereof*

In confirmation of hypothesis two (H2)<sup>78</sup>, the IIS licence and structure were instrumental in providing some entrepreneurs with subsidised access to resources. The thesis found that entrepreneurs that had free access to enterprise sites saved about 18 per cent of the total enterprise start-up cost (whereas IIS free

---

<sup>78</sup> As discussed in chapter seven, part of H2 that referred to easing the bureaucratic business legalisation processes was not confirmed.

duty import generated about 13 per cent cost of the goods imported). Additional institutional support provided to some IIS assisted entrepreneurs also considerably cut the lead time for acquiring state controlled and allocated resources like power and enterprise sites.

**Evaluating the performance of the IIS:** In the thesis, IIS support take-up rate, level of support delivered and revenue foregone were used as criteria to assess the performance of the IIS. As discussed above, during 1992-98, the IIS gross take-up rate was low, that is only 27 per cent of IIS licensed projects started up, and about 10 per cent of start ups (that is 419) drew on the IIS benefit. This performance rate also compared badly with a similar criterion used in the 1960s where almost all IIS licensees drew on the IIS benefits and implemented projects. The thesis, therefore, concluded that the claim by the investment authorities that IIS assisted thousands of enterprise start ups over 1992-98 was simply misleading and not sustained by the evidence.

On the type and level of the IIS support delivered, entrepreneurs' benefit was largely drawn from duty free import of capital goods as these accrued to them following direct importing of goods (as the law required) by the entrepreneurs themselves. Consequently, operations of local dealers in imported capital goods were adversely affected as they lost their business now taken over by the entrepreneurs themselves. As a consequence of importing capital goods, entrepreneurs incurred additional costs like loss of advisory services on installation and repair and maintenance that they would have received from specialised capital importing local companies. Moreover, there were also incidences where the entrepreneurs made expensive mistakes in the specification of the orders for capital goods which was largely due to lack of experience in importing machines.



At the national level the thesis uncovered new evidence on the level of tax revenue foregone due to the IIS. Accordingly, over 1992-98 from exemption on imported capital goods alone, an estimated *birr* 526 million revenue has been foregone. Moreover, over 90 per cent of the revenue foregone (as well as other indirect IIS assistance) went to assist a few large scale projects in Addis Ababa and Tigray that were least dependent on government assistance to start up enterprises.

Evidence from the case studies also strongly suggested that income tax based IIS benefits were limited because shortly after start-up (that is during the grace period) enterprises barely produced any profits and entrepreneurs were unable (or unwilling) to comply with the costly regulations that required financial record keeping. Consequently, guiding enterprise start ups across selected locations and industries through IIS income tax incentives was largely ineffective.

### 8.3 Conclusion and Recommendation

The two major conclusions that emerged from this study were that, first, the influence of investment incentives on the timing, type, location and size of IIS assisted SME was limited. And second, the IIS licence and structure played a vital role in mediating entrepreneurial access to enterprise start up resources. But what does the low impact of the IIS suggest, and more importantly, what lessons emerge from this study? With a view to leading to the recommendations of the thesis, the next section deals with these questions.

#### 8.3.1 A re-examination of issues and the bigger picture

The reasons why the IIS proposition was flawed and why the IIS mediated access to resources were very much interrelated. The thesis showed that investment incentives did not influence the behaviour of entrepreneurs because, first, many entrepreneurs' decisions relating to starting enterprises were triggered by their experience, resources and attributes like education level. These factors, in turn, influenced the limited take up rate of the IIS assistance. The fact that financial

resources were so meagre (and external financing so inadequate) also limited the size of enterprises as well as opportunities to look for activities and locations that were less familiar to the entrepreneurs. Infrastructure and social and psychological reasons (such as entrepreneurs' attachment to areas where they lived) also limited SME founders' mobility between sectors and locations.

Therefore, as discussed above, it was only a few projects of significant size and mobile across sectors and locations that appropriated most of the IIS support. It follows, therefore, the IIS barely added to SMEs start-up and growth in Ethiopia.

Second, the IIS licence mediated entrepreneurial access to resources that the government controlled and allocated like enterprise sites. This was in part because the IIS, as a single-theme enterprise support initiative, did not consider the broader problems of enterprise start up and growth (like policy related problems and inadequate technical and managerial skills of entrepreneurs). Entrepreneurs' access to resources was also facilitated in exchange for the entrepreneurs promoting the interests of the government including recognition of its stance on the control and allocation of resources (chiefly land).

Therefore, among other things, limited size and entrepreneurial quality of SME founders, the constraining environment for enterprise start up and IIS assistance being limited to physical capital accumulation made the IIS initiative and objectives largely unsuccessful. Reflecting on the mistakes in enterprise policy making and constraints to the implementation of the IIS, below I draw out the lessons from the study (these lessons also have broader implications for enterprise development). In the discussion, I focus not on rejecting government enterprise support initiatives *per se* but on why and when intervention in the enterprise sector is likely to fail.

The major mistakes in enterprise policy making (especially the IIS) and constraints to the implementation of the IIS were:



*First, over-identification of the problems of enterprise start-up*

The thesis documented a wide range of constraints to enterprise development including lack of serviced enterprise sites and bureaucratic government regulations. Without sufficiently involving stakeholders (particularly the entrepreneurs), policy makers singled out shortage of investment as the main problem of enterprise development. And thereby they assisted enterprise development by subsidising investment in physical assets at start up and early growth stages enterprises. The emphasis on physical assets accumulation, albeit essential, was misplaced because, among other things, these assets cannot be used without the technical and managerial abilities of the entrepreneurs.

*Second, a limited range of tax incentives was used to act on multiple problems and government objectives.*

The government used investment incentives to address multiple objectives like regionally balanced enterprise start-up. Most of these objectives were poorly matched by the means to implement them. Moreover, by way of assisting entrepreneurs, the government chose to enter into a unique relationship with them and provided some of them with a gateway to resources. The consequences of this state-private sector relationship was significant. In the short run, entrepreneurs that would not otherwise have required IIS assistance for enterprise start-up joined the scheme. The long term consequence was that, in a piecemeal way and against the constitution of the country, the IIS was serving as a device to change the structure of property rights over land in favour of private ownership.

*Third, institutions that promoted investment incentives were resistant to change and less keen to learn from experience*

The Ethiopian Investment Authority and the regional offices gradually became larger and centralised. Moreover, as the IIS was reintroduced in the early 1990s it



failed to address problems of SMEs such as in entrepreneurship development. It also failed to learn from other countries' experiences on local and SMEs development. Instead Ethiopian policy makers used the same old investment incentives (as they did in the 1950s and 1960s) to support local enterprises, SMEs development and attracting FDI. In short IIS policy and institutions resisted changing with the changing environment to provide entrepreneurs with support in the areas they needed most.

*Four, endemic problems of the Ethiopian enterprise economy as constraints to implementing enterprise support initiatives*

In addition to the immediate IIS related problems, there were endemic problems in the enterprise economy. These problems included misguided government policies such as regulatory barriers at entry and long established cultural and religious barriers such as the stigmatisation of entrepreneurs. Added to these were national structural problems such as poor physical infrastructure (like power and roads) and institutional structures (banking, business information system, promotional services, advocacy agencies and institutions for developing technical and managerial skills).

The bigger issues that emerged from the thesis were, therefore, how to identify enterprise development problems, and the means to address these problems (including human and financial resources and institutions). Equally important was the issue of coordinating enterprise support policies across themes.

In the light of the foregoing discussion, the lessons that emerged from this thesis were:

- that if an enterprise support initiative does not fit into the socio-economic environment (as the IIS largely did not) then the initiative is bound to be ineffective.

- if an enterprise support initiative over-identifies enterprise or entrepreneurs' problems or becomes too prescriptive (as the IIS did) then it is likely to be ineffective. And,
- if an enterprise support initiative attempts to address multiple objectives but with inadequate and inappropriate means (as the IIS did) then it is unlikely to meet its objectives.

The foregoing discussion and these lessons form the perspective that this study suggests for the future development of the Ethiopian enterprise economy.

### 8.3.2 Perspectives on the enterprise support agenda

This thesis on the role and impact of the Ethiopian investment incentives scheme showed a distinctive source of enterprise support policy that may be referred to as promoter-centred. The scheme, which was an innovation at the time, emerged in 1950. And with the exception of 1975-90 it prevailed as the most important enterprise support initiative in the land. However, even when it was reintroduced in the 1990s it was driven by the political decision making domain with very little contribution from the broader system of enterprise development (comprising the entrepreneurs, professional associations, chambers of commerce, financial and training institutions, etc.).

Moreover, a scheme that was originally meant to increase 'modern' industry got added to to help indigenisation and SMEs start ups. However, the basic instruments remained and were not up to the bigger job. Hence the IIS ended up in the 1990s being used as much as a way of getting 'formal' approval for an investment (that can then be used to get land, energy supply, etc.) as to develop enterprises.

This thesis suggests that, as a perspective to enterprise development, an enterprise support initiative should primarily consider needs, potentials and constraints of the enterprises and entrepreneurs. Stakeholders (such as the entrepreneurs, professional associations, financial and training institutions, relevant government



and non-governmental agencies) have to take part in enterprise policy initiation, decision and implementation. This is a difficult (but necessary) task because in practice it means debate over enterprise development problems, potentials, identification of solutions and beneficiaries, resources and institutions has to be widely carried out and the negotiated outcome of such debates between and within stakeholders should result in enterprise development initiatives. As it stands in Ethiopia institutional arrangements for making stakeholders participate in the policy making processes (especially for small enterprises) hardly exist. Even within the small circle of policy makers there has barely been enough time given for discussion on enterprise policies<sup>79</sup>.

The background research to this thesis (chapter three) showed that existing and emerging enterprise support initiatives (like engineering design and tools enterprise) were barely coordinated. Moreover, none of these initiatives were demand driven nor had adequate rationales to merit the commitment of resources. Nor were the few enterprise initiatives that the country had based on networks and collectives that minimised costs and maximised external benefits. Furthermore, due to lack of coordination and central guidance, conflict between government agencies was created (as between the EIA that offered investment incentives and the Ministry of Finance and the land lease boards that lost revenues). Therefore, as a second perspective, the thesis suggests that enterprise promotion initiatives need to be coordinated.

The benefits from coordinating enterprise support initiatives is well documented (see for example, Evans, 1992 and Rodrik, 1995). In fact lack of coordination and guidance for enterprise development could be the key difference between

---

<sup>79</sup> Since the mid 1990s some interested parties have started commenting about policies through the media, and have written to and/or phoned the relevant agencies that initiated the policies (Amare Wodajo, 1998). Such initiatives need to be encouraged.



Ethiopia and South East Asian countries that followed similar but successful investment incentives schemes (Evans, 1992 and Rodrik, 1995). For example, according to Rodrik (1995), South Korea and Taiwan increased private return for investment by removing impediments to entry and coordinating and leading investment into socially desired areas. Both South Korea and Taiwan used comprehensive incentives schemes through which they created the investment climate, offered a range of incentives like cheap credit, insured risky investment in specific sectors, provided tax incentives such as reduced income tax from company earnings, and offered holidays for tax exemptions. Partly because Ethiopia's scheme was not as comprehensive and coordinated as that of South Korea and Taiwan, it bore little fruit.

I reiterate that the explanations for inadequate enterprise development in Ethiopia were many including errors in policy making, cultural barriers, resources limitations and natural disasters. But solutions were not as diverse and coordinated as they should have been. Consequently, many discrete Ethiopian enterprise policies suffered successive pitfalls. For example, there was excessive sector and spatial dichotomy. Policy making, as showed in this thesis, lacked evidence and merit to suggest manufacturing should be promoted over agriculture or the other way round. Similarly, there was very little evidence for the centre-periphery dichotomy nor whether the policies actually produced results. The specific recommendations made below, therefore, rest on the foregoing perspectives.

### 8.3.3 Recommendations

*First, change the paradigm of the enterprise support system, and place enterprise development at the heart of social and economic development policy*

At the heart of this recommendation is change in the paradigm of the enterprise support system (the thinking, institutions and instruments of support)<sup>80</sup>. This change needs to recognise, first, that the critical mass of entrepreneurs is small and needs wide ranging support. As demonstrated in the thesis, the current emphasis on encouraging enterprise development through subsidising physical asset accumulation may add to entrepreneurs' resources but it is not going to increase the number of entrepreneurs (especially SME founders). The evidence from the case studies consistently demonstrated that the major driving forces of enterprise start ups were entrepreneurs' technical and managerial skills, and internally generated resources (including finance). Moreover, enterprise start ups were supported where there was better infrastructure, market and a broader enabling environment. The implications are clear: assist enterprise development through the developing infrastructure, the education system (particularly technical education), eliminating bureaucratic constraints.

Second, the perception and idiom 'industrialisation is the engine of growth' needs some consideration. To create dynamism in the economy Ethiopia needs enterprises of all sizes (not just larger manufacturing enterprises). The industrialisation drive (often meaning manufacturing enterprises) is desirable, but needs to be part of the whole enterprise economy. SMEs in all industries, particular for their strengths in job creation, assist in addressing the catalogue of

---

<sup>80</sup> Removing the privileges of tax exemptions from duties on imported capital goods and company tax is not what is suggested here (as this would cause adverse reactions from the entrepreneurs and multinational financial institutions like the World Bank). More importantly, it is the fundamental thinking that gives utmost importance to the IIS initiative and the huge institution that supports it that need changing.

development problems that the country faces. It is such a broader view on enterprise development that leads to the consideration of a juxtaposition of factors (like the development of entrepreneurship by addressing destructive cultural practices and bureaucratic constraints).

Finally, involving stakeholders (professional associations, enterprises, NGOs, government at all levels, relevant departments such education) in policy development and implementation avoids mistakes in policy making and maximises the dividends from policy initiatives. It is suggested that these views on enterprise development need to be placed at the heart of wider social and economic development policy making in the country.

*Second, create an enterprise development structure.*

Such a structure (an 'enterprise development agency') needs to perform a wide ranging functions like attracting inward investment and local enterprise development, as for example, Scottish Enterprise does (McQuaid, 1997).

Moreover, such structure has to work with stakeholders, coordinate enterprise initiatives at all levels and produce pragmatic and cost effective solutions to concrete problems. Such a structure should assist the development of demand led, and well financed enterprise initiatives. Moreover, it is also important for an enterprise development agency to see ways in which indigenous institutions (like ikoub) are imaginatively used in resource mobilisation for enterprise development.



*Third, critically re-examine property rights issues especially those related to land.*

Even within existing ownership patterns, just and timely allocation of land makes more difference to enterprise start-up and growth than the IIS did.

*Finally, I strongly recommend that an enterprise support initiative should be regularly monitored, and also occasionally evaluated to ensure that it has created impacts.*

Taking the foregoing recommendations on board is a hugely challenging task and requires resources (people, finance and institutions). My view on this is that part of the essential resources already exist, for example, EIA structure and staff can be redeployed to fit these recommendations. Most of all, the emphasis on promoting investment incentives has to be balanced by providing such assistance as relevant information, advice and training that the entrepreneurs require. Moreover, without dwelling on the details, additional resources have to be generated to support key areas of enterprise development (as in energy sources development).

#### **8.4 Limits to generalisation and agenda for further research**

In terms of its sources of evidence and methodological devices, this thesis on the role and impact of investment incentives on enterprise start-up and growth in Ethiopia was the first comprehensive study undertaken. Compelling evidence emerges which justifies the formulation of generalisations about the role and impact of investment incentives on the sections of Ethiopian enterprises (SMEs) studied.

In brief the conclusions of the study were that, first, the influence of investment incentives on the timing, industry, location and size of IIS assisted SME was limited. This conclusion has significant implications not only for Ethiopia but also for many LDCs that extensively use the instrument of investment incentives (especially a small range of tax exemptions) to assist their enterprise sector across selected industries and regions. Second, and on a more positive note, the IIS

licence and structure played an important role in mediating entrepreneurial access to enterprise start up resources. These conclusions are testimonies to the fact that the relevant research questions were answered and the hypotheses were explored, and hence the objectives of the study were achieved. However, some factors limit whether the conclusions made about the role and impact of the IIS in Ethiopia apply to other LDCs. Some of these factors that limit generalisation and require further research are:

First, for the reason discussed in chapter one, some elements of the IIS were not sufficiently explored. For example, IIS impacts on indigenous but large scale enterprises and foreign direct investment were not adequately researched. Enterprise growth in the thesis was also narrowly applied to the formative stage of IIS assisted SMEs. Finally, the thesis did not thoroughly study all the possible indirect impacts of the IIS on enterprise development. Future research should consider these areas.

Second, clearly the conclusions of the study, in particular that referring to the limited influence of investment incentives on the industry and location of SMEs, were broadly consistent with those emerging from studies on developing countries (with the exception of some Southeast Asian countries like South Korea where investment incentives seemed to have worked). However, the available country studies on the role and impacts of investment incentives were generally few in number and often considered limited aspects of investment incentives like spatial effects. Therefore, more comprehensive studies are required to establish generalisable roles and impacts of investment incentives in LDCs. Furthermore, the case for more research emerges from the fact that one of the important conclusions of the thesis, that is *the IIS licence and structure played a vital role in mediating entrepreneurial access to enterprise start up resources*, rested on the particular setting for enterprise development put in place in Ethiopia (this setting,

like the procedures for access to enterprise sites, may not necessarily be the same in other countries). Therefore, any generalisation about the overall role and impact of investment incentives needs to take account of the results of such studies.

Third, and outside the IIS system, areas that need future research and surveys in Ethiopia include the birth and attrition rates of enterprises (these were not available to build a background analysis on the study of Ethiopian enterprises). Several impact based studies on existing enterprise support initiatives also need to be considered. Most important of these is the initiative that seeks to create an indigenous technology base for the development of SMEs (recall that the IIS's fundamental proposition largely rested on technology transfer). This initiative is promoted by the Ethiopian Engineering Design and Tools Enterprise (EEDTE). Therefore, it will be interesting to study the extent to which the EEDTE has created the environment that produces technology appropriate to the Ethiopian conditions.

To conclude, it has to be noted that, in spite of its constraints, there are prospects for enterprise development in Ethiopia. These prospects are accentuated by, among other things, a huge supply of low wage labour, land and land based resources, high domestic demand for consumer goods, and an improved political climate for enterprise development. It is hoped, therefore, that the conclusions and recommendations of this thesis will assist the development of the Ethiopian enterprise sector.



## 9. References

### 9.1 General references

- Abdela Jemal (1995) 'The Profile of Entrepreneurship in Ethiopia' in Ayalew Zegeye and Habteselassie Hagos (eds), *Proceedings of the First Annual Conference on Management in Ethiopia on the Theme Entrepreneurship*, AAU, Ethiopia.
- Addis Ababa University (AAU) (1995), *Report on the 1994 Socio-economic Survey of the Major Urban Centers in Ethiopia*, Department of Economics/AAU and University of Gotenborg, Sweden.
- Addis Tribune*, 23 August, 1996, and March 20, 1998, Addis Ababa.
- Admit Zerihun and Getachew Belay (1996) 'Private Sector Development in Ethiopia: An Assessment of the Enabling Environment and Incentive Structures' in Tadesse Abadi and Tekie Alemu (eds) *Adjustment in Ethiopia: Lessons for the Road Ahead*, EEA, Addis Ababa.
- African Development Bank (1997) *African Development Report 1997: Fostering Private Sector Development in Africa*, Oxford University Press, New York.
- Allen, Kevin, Begg, H, McDowall, S and Walker, G (1986) *Regional Incentives and Investment Decision of the Firm*, Dept. of Trade and Industry, London.
- Amendola, Mario and Bruno, Sergio (1990) 'The behaviour of the innovative firm: Relations to the environment' in *Research Policy*, Vol. 19, pp. 419-433.
- Anderson, Dennis (1990) 'Investment and Economic Growth' in *World Development*, Vol. 18, No. 8, pp. 1057-1079.
- Arega Hailu Teffera (2000) 'Tariff Reform, Tariff Rates and Tariff Revenue in Ethiopia' in *Economic Focus*, Vol. 4, No. 4, pp. 32-34.
- Arestis, Philip and Sawyer, Malcolm (eds) (1998) *The Political Economy of Policies*, Macmillan Press Ltd, London.
- Argyris, Chris (1970) *Intervention Theory and Method: A Behavioural Science View*, Addison-Wesley Publishing Company, Reading, Massachusetts.
- Arrow, Kenneth J (1974) *Essays in the Theory of Risk-Bearing*, North-Holland Publishing Company, Amsterdam.
- Asiedu, Elizabeth (2002) 'On the Determinants of Foreign Direct Investment to Developing Countries: Is Africa Different?' in *World Development*, Vol. 30, No. 1, pp. 107-119.

- AXE, Creation D'Enterprises, 1994, *Towards a SME Development Programme in Ethiopia* (Draft), Addis Ababa.
- Ayalew Zegeye (1995) 'Entrepreneurial Development in Ethiopia: Some Notes' in Ayalew Zegeye and Habteselassie Hagos (eds), *Entrepreneurship: Proceedings of the First Annual Conference on Management in Ethiopia*, Addis Ababa.
- Bahiru Zewde (1991) *A History of Modern Ethiopia*, Addis Ababa University Press, Addis Ababa
- Baumol, William J (1968) 'Entrepreneurship and Economic Theory' in *The American Economic Review*, Vol. LVIII, No. 2, pp. 64-71.
- Befekadu Degefe (1994) 'Strategies and Macroeconomic Policies for the Development of the Private Sector' in Getachew Yoseph and Abdulhamid Bedri Kello (eds), *The Ethiopian Economy: Problems and Prospects of Private Sector Development, Proceedings of the Third Annual Conference on The Ethiopian Economy*, Addis Ababa.
- Befekadu Degefe and Berhanu Nega (eds) (2000) *Annual Report on the Ethiopian Economy*, Vol. I, 1999-2000, The Ethiopian Economic Association, Addis Ababa.
- Bekure Woldesemait (1980) 'Pre-1974 Industrialization in Ethiopia and Its Socio-Economic Consequences: The Example of the Addis Ababa Region' in *Proceedings of the Seminar on the Industrial Transition in Ethiopia*, IDR, 1980.
- Bell, J, 1993, *Doing Your Research Project*, Second Edition, Open University Press, Buckingham.
- Bennett, Robert and Robson, Paul (1999) 'Business Link: Use, Satisfaction and Comparison with Business Shop and Business Connect' *Policy Studies*, Vol. 20, No 2, pp. 107-131.
- Berhane Mewa (1998) 'Structural Adjustment Reform in Ethiopia: Views from the Trade and Industry Community' in *Economic Focus*, Vol. 1, No. 3, pp 15-18.
- Berhanu Abegaz (1994) 'Introduction: the challenges of arrested development' in Berhanu Abegaz (ed) *Essays on Ethiopian Economic Development*, Aldershot, Avebury.
- Bhagwati, Jagdish *et al* (1984) 'DUP Activities and Economic Theory' in Colander, D. C (ed) *Neoclassical Political Economy: The Analysis of Rent-Seeking and DUP Activities*, Ballinger Publishing Company, Cambridge, MA.



- Binks, M and Jennings, A (1986) 'New Firms as a Source of Industrial Regeneration' in Scott, M *et al* (eds) *Small Firms Growth and Development*, Gower, Aldershot, England.
- Binks, Martin and Vale, Philip (1990) *Entrepreneurship and Economic Change*, McGraw-Hill Book Company, London.
- Birley, S (1989) 'The Start-Up' in Burns, P and Dewhurst, J (eds) *Small Business and Entrepreneurship*, MacMillan, England.
- Blackmore, Chris and Ison, Ray (1998) 'Boundaries for Thinking and Action' in Thomas, A., Chataway, J and Wuyts, M (eds) *Finding out Fast: Investigative Skills for Policy and Development*, Sage, London.
- Bolton, J E (1971) *Small Firms: Report of the Committee on Inquiry on Small Firms*, HM Stationery Office, London.
- Borello, Jose Antonio (1995) 'Regional Development and Industrial Promotion in Argentina: A Review of Events and Writings', in *International Journal of Urban and Regional Research*, Vol. 19, No. 4, pp. 576-592.
- Borin, Luciano *et al* (1994) *Ethiopia: Business Development Action Plan (BDAP)/Draft*, Addis Ababa.
- Bridge, S, O'Neill, K. and Cromie, S. (1998) *Understanding Enterprise, Entrepreneurship & Small Business*, Macmillan Business, Bristol, UK.
- Bromley, Ray (1985) *Planning for Small Enterprises in Third World Cities*, Pergamon Press, Great Britain.
- Brook Debebe (1999) 'Ethiopia's Export Sector: Performance and Prospects' in *Economic Focus*, Vol. 2, No. 2, pp. 5-10.
- Brusco, S (1995) 'Local Productive Systems and New Industrial Policy in Italy' in Bagnasco, Arnaldo and Sabel, Charles (eds) *Small and Medium-Sized Enterprises*, Pinter, Britain.
- Cameron, John (1988) *The Development of Rural Small-Scale Industries in Ethiopia within a National Food and Nutrition Strategy Framework*, Consultant Report, FAO Project ETH/TCP/8851 I, Addis Ababa.
- Carlisle, Howard M (1975) 'Measuring the Situational Nature of Management' in Newstrom, John W. *et al* (eds) *A Contingency Approach to Management: Readings*, McGraw-Hill Book Company, New York.
- Casson, Mark (1987) 'Entrepreneur' in Eatwell, J *et al* , (eds), *The New Palgrave: A Dictionary of Economics*, Vol. 2, Macmillan Press Limited, London, .



- Chataway, Joanna (2000) 'The Private Sector and Competitive Markets in Development' in Robinson, D., Hewitt, T. and Harris, J. (eds) *Managing Development: Understanding Inter-Organizational Relations*, Sage Publication in Association with The Open University, London.
- Chataway, Joanna and Wield, David (1994) 'Change and continuity in biotechnology and new materials innovation: The evolution of technologies, markets and institutions' in *International Journal of Materials and Product Technology*, Vol. 9, No. 4/5/6, pp. 464-481.
- Chataway, Joanna and Wield, David (2000) 'Industrialization, Innovation and Development: What Does Knowledge Management Change?' in *Journal of International Development*, Vol. 12, p 803-824.
- Chen, Huet-Tsyh, 1990, *Theory-Driven Evaluation*, Sage Publications, Newbury Park, London and New Delhi.
- Clapham, C. (1988) *Transformation and Continuity in Revolutionary Ethiopia*, Cambridge University Press, Cambridge.
- Coase, R. H. (1988) *The Firm, the Market and the Law*, University of Chicago Press, Chicago and London.
- Cockroft, Laurence (1992) 'The Past and Future Potential of Foreign Investment' in Stewart, Frances, Lall, S., and Wangwe, S. (eds) *Alternative Development Strategies in SubSaharan Africa*, The Macmillan Press Limited, London.
- Coen, R. M., and Eisner, R. (1987) 'Investment' in Eatwell, J. *et al* (eds.) *The New Palgrave: A Dictionary of Economics*, Vol. II, Macmillan Press, London.
- Colander, David C (ed) (1984) *Neoclassical Political Economy: The Analysis of Rent-Seeking and DUP Activities*, Ballinger Publishing Company, Cambridge, MA.
- Collins English Dictionary* (1986), Second Edition
- Cooper, Arnold C. (1986) 'Technical Entrepreneurship: What do we know?' in Curran, J., John Stanworth and David Watkins (eds), *The Survival of the Small Firm 2: Employment, growth, technology and policies*, Gower, England.
- Cortes, Mariluz; Berry, Albert; and Ishaq, Ashfaq (1987), *Success in Small and Medium - Scale Enterprises: The Evidence from Colombia*, Oxford University Press, The World Bank, New York and Washington D.C.
- Curran, James (1999) *The Role of Small Firms in the UK Economy: Hot Stereotypes and Cool Assessments*, Small Business Research Trust Report, OU Business School, Milton Keynes.

- Curran, James and Stanworth, John (1986) 'Small Firms, Large Firms: Theoretical and Research Strategies for the Comparative Analysis of Small and Large Firms in the Wider Environment' in Scott, M *et al* (eds) *Small Firms Growth and Development* Gower, England.
- DAHSI (1997) *DAHSI News Letter*, Vol. 1, No. 1.
- Daniels, Kevin and Henry, Jane (1998) 'Strategy: A Cognitive Perspective' in Segal-Horn, S (ed) *The Strategy Reader*, Blackwell, Oxford, UK.
- Dejene Aredo (1994) 'Land, Cooperatives and Contract Farming Arrangements of the Wonji/Shewa Sugar Estate' in Desalegn Rahmato (ed) *Land Tenure and Land Policy in Ethiopia after the Derg*, Land Tenure Project, IDR/Addis Ababa University, Printed in Norway.
- Dejene Aredo and Teferri Regassa (1995) 'Land Tenure: Theory and Policy Issues in Ethiopia' in Dejene Aredo and Mulatu Demeke (eds), *Ethiopian Agriculture: Problems of Transformation*, Proceedings of the Fourth Annual Conference on the Ethiopian Economy, Addis Ababa.
- Desalegn Rahmato (1985) *Agrarian Reform in Ethiopia*, The Red Sea Press, Trenton, New Jersey.
- Desalegn Rahmato (ed) (1994) *Land Tenure and Land Policy in Ethiopia after the Derg*, Land Tenure Project, IDR/Addis Ababa University, Printed in Norway.
- Driver, Ciaran and Moreton, David (1992) *Investment, Expectations and Uncertainty*, Blackwell, Oxford, UK and Cambridge, USA.
- Dunleavy, Patrick (1991) *Democracy, Bureaucracy and Public Choice: Economic Explanations in Political Science*, Harvester Wheatsheaf, Hemel Hempstead, England.
- Duri Mohammed (1974) 'Private Foreign Investment in Ethiopia' in Gerald J Gill (ed) *Readings on the Ethiopian Economy*, HSI University, 19974.
- Economist*, 13 March 1993.
- Economist*, Nov. 6, 1999.
- EEA (1997a) *Economic Focus*, Vol. 1, Issue No. 2
- EEA (1997b) 'Culture and Economic Development' in *News Letter*, Vol. 3 and Vol. 4.
- EEA (1999/2000) *Economic Focus*, Vol. 2 Dec. 1999 - Jan. 2000 Issue.
- EIA (1997a) *Investing in Ethiopia*, Addis Ababa.

- EIA (1997b) *A Feasibility Study on Establishment of a Seed Capital in Ethiopia*, Addis Ababa.
- EPRDF (1994) *Ethiopian Peoples Revolutionary Democratic Front's Programme for Development, Peace and Democracy*, Addis Ababa.
- Eshetu Chole (1995) 'Running to Keep in the Same Place: Industrialization 1941-74' in Shiferaw Bekele (ed), *An Economic History of Modern Ethiopia*, CODESRIA, Senegal.
- Eshetu Chole and Mekonen Manyazewal (1992) 'The Macroeconomic Performance of the Ethiopian Economy' in Mekonen Tadesse (ed) *The Ethiopian Economy: Structure, Problems and Policy Issues*, EEA, Addis Ababa.
- Evans, P. (1992) 'The State as Problem and Solution: Perdition, Embedded Autonomy, and Structural Change' in Haggard, S. and Kaufman, R. (eds) *The Political Economic Adjustment: International Constraints, Distributive Conflicts, and the State*, Princeton University Press, New Jersey.
- Financial Times*, June 22, 2000.
- Fisher, M M (1988) 'Business Formation and Regional Development: Some Major Issues' in Giaoutzi, M. *et al* (eds) *Small and Medium Size Enterprises and Regional Development*, Routledge, Chatham, Kent.
- Forbes, Naushad and Wield, David (2000) 'Managing R&D in technology-followers' in *Research Policy*, Vol. 29, p. 1059-1109.
- Fotopoulos, Georgios and Spencer, Nigel (1999) 'Spatial Variations in New Manufacturing Plant Openings: Some Empirical Evidence from Greece' in *Regional Studies*, Vol. 33.3, pp. 219-229.
- Frimpong-Ansah, J. H. (1992) 'The Mobilization of Domestic Resources for Africa's Economic Recovery and Development' in Frimpong-Ansah, J. H. and Ingham, B (eds) *Saving for Economic Recovery in Africa*, ACEPOR/James Curry Ltd, London.
- Galenson, Alice (1984) *Investment Incentives for Industry: Some Guidelines for Developing Countries*, World Bank Staff Working Papers No. 669, The World Bank, Washington, D C.
- Gastanaga, Victor, Nugent, J. B, and Pashamova, B. (1998) 'Host Country Reforms and FDI Inflows: How Much Difference do they Make?' in *World Development*, Vol. 26, No. 7, pp. 1299-1314.
- Gavian, Sarah and Gemechu Degefa (1994) 'Commercial Investors and Access to Land' in Desalegn Rahmato (ed) *Land Tenure and Land Policy in Ethiopia*



*after the Derg*, Land Tenure Project, IDR/Addis Ababa University,  
Printed in Norway.

- Gelderen, Marco van, Frese, Michael and Thurik, Roy (2000) 'Strategies, Uncertainty and Performance of Small Business Start ups' in *Small Business Economics*, Vol. 15, pp. 165-181.
- Giaoutzi, M., Nijkamp, P. and Storey, D. J. (1988) *Small and Medium Size Enterprises and Regional Development*, Routledge, Chatham, Kent.
- Gibb, A. and Scott, M (1986) 'Understanding Small Firm Growth' in Scott, M *et al* (eds) *Small Firms Growth and Development*, Gower, Aldershot, England.
- Gibb, Allan, (1987a) 'Enterprise Culture - Its Meaning and Implications for Education and Training' in *Journal of European Industrial Training*, Vol. 11, No. 4.
- Gibb, Allan, (1987b) 'Designing Effective Programmes for Encouraging the Business Start-up Process: Lesson from the UK Experience' in *Journal of European Industrial Training*, Vol. 11, No. 2, pp. 24-32.
- Gorg, Holger, Strobl, E. and Ruane, F. (2000) 'Determinants of Firm Start -Up Size: An Application of Quantile Regression for Ireland' in *Small Business Economics*, Vol. 14, pp 211-222.
- Grant, Don Sherman, II (1996) 'The Political Economy of New Business Formation Across the American States', in *Social Science Quarterly*, Vol. 77, No. 1, pp. 28-42.
- Grant, Robert (1998) *Contemporary Strategy Analysis*, third edition, Blackwell, Malden, MA and Oxford, UK.
- Gray, Colin (1998) *Enterprise and Culture*, Routledge, London
- Greer, Douglas F (1992) *Industrial Organization and Public Policy*, third edition, Macmillan Publishing Company, New York.
- Guba, Egon G (ed) (1990) *The Paradigm Dialogue*, Sage Publications, Newbury Park, London and Delhi
- Gulilat Kebede (1994) 'The New Investment Law: Basic Features and Limitations with Reference to the Industrial Sector' in Mekonen Taddesse, Abdulhamid Bedri Kello (eds) *The Ethiopian Economy: Problems of Adjustment*, Ethiopian Economic Association, Addis Ababa, Ethiopia.
- Habtamu Wondimu (1995) 'Dominant Values and Parenting Styles: Major Limiting Factors on the Development of Entrepreneurship in Ethiopia' in Ayalew Zegeye and Habteselassie Hagos (eds), *Entrepreneurship*:

*Proceedings of the First Annual Conference on Management in Ethiopia, Addis Ababa.*

- Hamer, Andrew Marshall (1985) *Decentralized Urban Development and Industrial Location in Sao Paulo, Brazil: A Synthesis of Research Issues and Conclusions*, World Bank Staff Working Papers, No. 732, The World Bank, Washington D.C, USA.
- Hammond, Laura C. (1994) 'Returnees, local farmers and big business: the politics of land allocation in Humera, Ethiopia' in Desalegn Rahmato (ed) *Land Tenure and Land Policy in Ethiopia after the Derg*, Land Tenure Project, IDR, Addis Ababa University, printed in Norway.
- Harper, M. (1984) *Small Business in the Third World: Guidelines for Practical Assistance*, John Wiley & Sons, Chichester.
- Harvey, J (1996) *Urban Land Economics*, Fourth Edition, Macmillan, London.
- Helleiner, G. K. (1992) 'Structural Adjustment and Long-term Development in SubSaharan Africa' in Stewart, Frances, Lall, S., and Wangwe, S. (eds) *Alternative Development Strategies in SubSaharan Africa*, The Macmillan Press Limited, London.
- Hewitt, Tom (1999) 'Institutional tension and private sector promotion in Tanzania: Whose Agenda?', in *technovation*, No. 19, pp.383-391.
- Hodgson, G. M. (1996) 'Varieties of Capitalism and Varieties of Economic Theory' in *Review of International Political Economy*, Vol. 3, No. 3, pp. 380-433.
- IEG (1955) *Economic Progress of Ethiopia*, Ministry of Commence and Industry, Addis Ababa.
- Ingram, W and Pearson, S (1981) 'The Impact of Investment Concessions on the Profitability of Selected Firms in Ghana' in *Economic Development and Cultural Change*, Vol. 29, No. 4, pp. 831-839.
- Itana Ayana (1994) 'The State and Performance of Public Enterprises in Ethiopia: The Case of State Farms' in A.B. Kello (ed), *Privatization and Public Enterprise Reform in Ethiopia*, Ethiopian Economic Association, Addis Ababa
- ITDG (2001) See (<http://itdg.org>, 25/09/01).
- Jalilian, Hossein and Weiss, John (2001) *Foreign Direct Investment and Poverty Reduction: Some Cross-Country Evidence*, DSA 2001 Conference Paper, IDMP, Manchester.

- Jenkins, Rhys (1992) 'Industrialisation and the Global Economy' in Hewitt, T., Johnson, H. and Wield, D. (eds) *Industrialisation and Development*, Oxford University Press/The Open Univesristy, Milton Keynes.
- Jovanovic, Boyan (1982) 'Selection and the Evolution of Industry' in *Econometrica*, Vol. 50, No. 3, pp. 649-670.
- Kaldor, Nicholas (1978) *Further Essays on Economic Theory*, Duckworth, London.
- Kamalkhani, Sylvie K. (1991) 'Promoting local capital: the role of the small enterprise development corporation (SEDCO) in Swaziland' in *Journal of Southern African Studies*, Vol. 17, Issue 2.
- Kets de Vries, M F R (1985) 'The Dark Side of Entrepreneurship' in *Harvard Business Review*, November-December 1985, pp. 160-167.
- Korten, D. (1972) *Planned Change in a Traditional Society: Psychological Problems of Modernization in Ethiopia*, Praeger Publishers, New York.
- Krugman, Paul (1995) 'Increasing Return and Economic Geography' in Greenhut, M. L. and Norman, G (eds) *The Economics of Location: Volume III: Spatial Microeconomics*, The International Library of Critical Writings in Economics, Britain/USA.
- Kuma Tirfe (1994) 'Reform in Trade and Service Sector' in A.B. Kello (ed) *Privatization and Public Enterprise Reform In Ethiopia*, EEA, Addis Ababa.
- Langrish, John (1993) *Case Studies as a Biological Research Process*, Research Paper 67, Institute of Advanced Studies, Manchester Metropolitan University.
- Lazonick, William (1991) *Business Organization and the Myth of the Market Economy*, Cambridge University Press, USA.
- Lenihan, H. (1997) 'An Evaluation of a Regional Development Agency's Grants in terms of Deadweight and Displacement' in *Conference Proceedings on Generating Growth*, Vol. I, ISBA, Belfast.
- Lewis, W. Arthur (1955) *The Theory of Economic Growth*, George Allen & Unwin Ltd, London.
- Little, Ian, Dipak Mazumdar, and John M. Page, Jr (1987) *Small Manufacturing Enterprises: A Comprehensive Study of India and Other Economies*, Oxford University Press, The World Bank, New York and Washington D.C.
- Loucks, K (1988) *Training Entrepreneurs for Small Business Creation: Lessons from Experience*, ILO, Geneva.



- Mallidi, K., Paraskevopoulos, A.T. and Paganelli, P. (1999) 'Process modelling in small-medium enterprise networks' in *Computers in Industry*, Vol. 38, pp 149-158.
- Markakis, John, 1974, *Ethiopia: Anatomy of a Traditional Polity*, Clarendon Press Oxford, Britain.
- Massey, D, Quintas, P and Wield, D (1992) *High Tech Fantasies: Science Parks in Society, Science and Space*, Routledge, London.
- McClelland, David C (1961) *The Achieving Society*, D. Van Nostrand Company, INC., Princeton, New Jersey.
- McCormick, D., Kinyanjui, M.N. and Ongile, G (1997) 'Growth and Barriers to Growth Among Nairobi's Small and Medium-Sized Garment Producers' in *World Development*, Vol. 25, No. 7, pp. 1095-1110.
- McCormick, Dorothy (1993) *Risk and Firm Growth: The Dilemma of Nairobi's Small-Scale Manufacturers*, Discussion Paper No. 291, Institute for Development Studies, University of Nairobi, Kenya.
- McPherson, Michael A (1995) 'The Hazards of Small Firms in Southern Africa' in *Journal of Development Studies*, Vol. 12, No. 1, pp. 31-54.
- McQuaid, Ronald W. (1997) 'Local Enterprise Companies and Rural Development' in *Journal of Rural Sciences*, Vol. 13, No. 2, pp. 197-212.
- Mead, Donald C and Liedhom, Carl (1998) 'The Dynamics of Micro and Small Enterprises in Developing Countries' in *World Development*, Vol. 26, No. 1, pp 61-74.
- Mekonen Ayalew (1995) 'The Links Between Agricultural and Industrial Production: The Case of Food and Beverage Industries' in Dejene Aredo and Mulatu Demeke (eds), *Ethiopian Agriculture: Problems of Transformation*, Proceedings of the Fourth Annual Conference on the Ethiopian Economy, Addis Ababa.
- Mekonen Ayalew (1997) 'The Links Between Small-Scale and Large-Scale Industries in Ethiopia: Structures, Problems and Prospects' in Wolday Amha, G. H. R Chipande and A. Tegegne (eds) *Small-Scale Enterprise Development in Ethiopia*, Ethiopia Economic Association, Addis Ababa.
- Mezgar, I., Kovacs, G.L. and Paganelli, P. (2000) 'Co-operative production planning for small and medium-sized enterprises' in *Int.J. Production Economics*, Vol. 64, pp 37-48.
- Miles, B. M. and Huberman, A. M. (1994) *Qualitative Data Analysis*, Second Ed., Sage Publications, Thousand Oaks, California.

- MOPED (1992) *Study on Social Dimensions of Adjustment in Ethiopia*, Addis Ababa, Ethiopia.
- Mulatu Wubneh (1982) *A Spatial Analysis of Urban Industrial Development in Ethiopia*, Maxwell School of Citizenship and Foreign Affairs, Syracuse University, New York.
- Mytelka, Lynn (1992) 'Ivorian Industry at the Cross-roads' in Stewart, F., Lall, S. and Wangwe, S (eds) *Alternative Development Strategies in SubSaharan Africa*, Macmillan, London.
- Mytelka, Lynn, K. (1988) *The Unfulfilled Promise of African Industrialization*, Paper prepared for presentation at the annual meeting of the African Studies Association, Chicago, 1988.
- Mytelka, Lynn, K. (2000) "'We the people': the transformation of state-TNC relations at the turn of the millennium' in *Journal of International Management*, Vol. 6, pp. 313-325.
- Nafziger, E.W and Terrell, Dek (1996) 'Entrepreneurial Human Capital and the Long-Run Survival of Firms in India' in *World Development*, Vol. 24, No. 4, pp. 689-696.
- Najmabadi, Farrokh and Lall, Sanjaya (1995) *Developing Industrial Technology: Lessons for Policy and Practice*, The World Bank, Washington, D.C.
- Navaretti, Giorgio Barba (1994) *What Determines Intra-Industry Gaps in Technology? A Simple Theoretical Framework for the Analysis of Technological Capabilities in Developing Countries*, Development Studies Working Papers, No. 77, Centreo Studi d'Agliano-Queen Elizabeth House, University of Oxford.
- North, Douglass C (1990) *Institutions, Institutional Change and Economic Performance*, Cambridge University Press, Cambridge, USA.
- Oakey, R. P and Cooper, S. Y (1995) 'High Technology Industry, Agglomeration and the Potential for Peripherally Sited Small Firms' in Greenhut, M. L, and Norman, G (eds) *The Economics of Location: Volume I: Location Theory*, The International Library of Critical Writings in Economics, Britain/USA.
- Observer*, 25 February, 2001
- OECD (1979) *Report on the Role of Industrial Incentives in Regional Development*, Paris.
- OECD (1993) *Small and Medium-sized Enterprises: Technology and Competitiveness*, Paris.



- Oshikoya, T (1994) 'Macroeconomic Determinants of Domestic Private Investment in Africa: An Empirical Analysis', in *Economic Development and Cultural Change*, Vol. 42, No. 3, pp. 573-596.
- Paloscia, R. (1991) 'Agriculture and Diffused Manufacturing in the Terza Italia: A Tuscan Case Study' in Whitmore, S. *et al* (eds) *Rural Enterprise: Shifting Perspectives on Small-Scale Production*, David Fulton, London.
- Pankhurst, R. (1961) *An Introduction to the Economic History of Ethiopia*, Lalibela House, England
- Pankhurst, Richard (1968) *Economic History of Ethiopia, 1800-11935*, Haile Selassie I University Press, Addis Ababa, Ethiopia.
- Pedersen, Poul Ove, Sverrisson, A. and van Dijk, M. P. (1994) *Flexible Specialization: The dynamics of small-scale industries in the south*, Intermediate Technology Publication, London.
- Peres, W. and Stumpo, G. (2000) 'Small and Medium-Sized Manufacturing Enterprises in Latin America and the Caribbean Under the New Economic Model' in *World Development*, Vol. 28, No. 9, pp 1643-1655.
- Piore, M. J., and Sabel, C. F. (1984) *The Second Industrial Divide: Possibilities for Prosperity*, Basic Books, New York.
- Reis, Ana Balcao (2001) 'On the welfare effects of foreign investment' in *Journal of International Economics*, Vol. 54, p.411-427.
- Reporter, Yekatit 30 1990 (E. C.)
- Rhodes, Ed and Wield, David (1994) 'Technology, Innovation Theory and the Implementation Process' in Rhodes, Ed and Wield, David (eds) *Implementing New Technologies: Innovation and Management of Technology*, second edition, Blackwell, Oxford, UK.
- Riddell, Roger C. (1990) *Manufacturing Africa: Performance and Prospects of Seven Countries in sub-Saharan Africa*, James Curry, London and Heinemann, Portsmouth, N.H.
- Robson, C (1993) *Real World Research: A Resource for Social Scientists and Practitioner - Researchers*, Blackwell, Oxford, UK and Cambridge, USA.
- Rodrik, D. (1995) 'Getting interventions right: how South Korea and Taiwan grew rich' in *Economic Policy* 20, April 1995, pp. 55-97
- Rogerson, C. M. (2001) 'In search of the African miracle: debate on successful small enterprise development in Africa' in *Habitat International*, Vol. 25, pp 115-142.



- Root, Franklin R. and Ahmed, Ahmed A. (1979) 'Empirical Determinants of Manufacturing Direct Investment in Developing Countries' in *Economic Development and Cultural Change*, Vol. 27, pp.751-767.
- Samuels, W J and Mercuro, N (1984) 'A Critique of Rent-Seeking Theory' in Colander, D C (ed) *Neoclassical Political Economy: The Analysis of Rent-Seeking and DUP Activities*, Ballinger Publishing Company, Cambridge, MA.
- Schaffer, Bernard and Wen-Hsien, Huang (1985) 'Distribution and the theory of access' in Bromley, Ray (ed), *Planning for Small Enterprises in Third World Cities*, Pergamon Press, Great Britain.
- Schmitz, Hubert (1992) 'On the Clustering of Small Firms' in *IDS Bulletin*, Vol. 23, No. 3, pp. 64-69.
- Schmitz, Hubert (1995) 'Collective Efficiency: Growth Path for Small-Scale Industry' in *The Journal of Development Studies*, Vol. 31, No. 4, pp. 529-566.
- Schmitz, Hubert (1997) *Collective Efficiency and Increasing Returns*, Working Paper 50, IDS.
- Schmitz, Hubert and Nadvi, Khalid (1999) 'Clustering and Industrialization: Introduction' in *World Development*, Vol. 27, No. 9, pp. 1503-1514.
- Schulpen, Lau and Gibbon, Peter (2002) 'Private Sector Development: Policies, Practices and Problems' in *World Development*, Vol. 30, No. 1, pp.1-15.
- Schumacher, E. F. (1973) *Small is Beautiful: A study of economics as if people mattered*, Blond and Briggs, London.
- Schumpeter, Joseph A (1961, original 1934) *The Theory of Economic Development: An Inquiry into the Profits, Capital, Credit, Interest, and the Business Cycle*, Galaxy Book, New York.
- Schwarz, William L. K. *et al*, (1968) *Industrial Investment Climate in Ethiopia*, Report No. 2, Prepared for the Technical Agency of IGE by Stanford Research Institute, California.
- Self, Peter (1993) *Government by the Market? The Politics of Public Choice*, Macmillan, London.
- Semlinger, K (1995) 'Industrial policy and small-firm cooperation in Baden-Wurttemberg' Bagnasco, Arnaldo and Sabel, Charles (eds) *Small and Medium-Sized Enterprises*, Pinter, Britain.
- Sen, Amartya (1975) *Employment, Technology and Development*, Clarendon Press, Oxford.

- Sengenberger, W., Loveman, G. and Piore, M. J. (eds.) (1990) *The Re-emergence of Small Enterprises: Industrial restructuring in industrialised countries*, ILO/International Institute for Labour Studies, Geneva.
- Shiferaw Bekele (1994) *Small & Medium Enterprises Development in Ethiopia: Opportunities and Challenges under a Structural Adjustment Programmes*, WASTE, Addis Ababa.
- Shiferaw Bekele (ed) (1995) *An Economic History of Modern Ethiopia*, CODESRIA, Senegal.
- Shiferaw Jammo (1995) 'An Overview of the Economy, 1941-74' in Shiferaw Bekele (ed) *An Economic History of Modern Ethiopia*, CODESRIA, Senegal.
- Sileshi Teferra (1988) 'Problems and Prospects of Regional Distribution of Industries in Ethiopia' in the *Proceedings of the II Workshop on Basic Aspects of Regional Development Planning*, Addis Ababa, Ethiopia.
- Siropolis, Nicholas, C. (1990) *Small Business Management: A Guide to Entrepreneurship*, Fourth Edition, Houghton Mifflin Company, USA.
- Smillie, Ian (1991) *Mastering the Machine: Poverty, Aid and Technology*, Intermediate Technology Publications, London.
- Smith, A (1976) *An Inquiry into the Nature and Causes of the Wealth of Nations*, Vol. I, Clarendon Press, Oxford.
- Solomon Wole (1996) 'Adjustment and Private Sector Investment in Ethiopia: An Overview' in Tadesse Abadi and Tekie Alemu (eds) *Adjustment in Ethiopia: Lessons for the Road Ahead*, Ethiopian Economic Association, Addis Ababa, Ethiopia.
- Stake, Robert E (1995) *The Art of Case Study Research*, Sage Publications, Thousand Oaks/Cal., London and New Delhi.
- Stanworth, M. J. K. and Curran, J. (1981) 'Growth & The Small Firm - An Alternative View' in Gorb, P. et al (eds.) *Small Business Perspectives*, Armstrong Publishing, London.
- Stewart, Frances, Lall, S., and Wangwe, S. (1992) 'Alternative Development Strategies: An Overview' in Stewart, Frances, Lall, S., and Wangwe, S. (eds) *Alternative Development Strategies in SubSaharan Africa*, The Macmillan Press Limited, London.
- Stokes, David (1998) *Small Business Management: A case study approach*, 3rd Edition, Ashford Colour Press, Great Britain
- Storey, D. J. (1982) *Entrepreneurship and the New Firm*, Routledge, London.

- Storey, D. J. (1994) *Understanding the Small Business Sector*, Routledge, London.
- Storey, D. J. and Johnson, S. (1987) *Are Small Firms the Answer to Unemployment?*, Employment Institute, London.
- Subrahmanya, M H Bala (1998) 'Shift in India's Small Industry Policy' in *Small Enterprise Development*, Vol. 9, No. 1. pp. 35-45.
- Sweeney, Gerry (1997) 'Lessons and Experiences from the Promotion of Entrepreneurship and SMEs in OECD Countries' in OECD (1997) *Entrepreneurship and SMEs in Transition Economies: The Visegrad Conference*, Paris.
- Tambek International Pvt. Lt. Co. (1996) *EPRDF's Five-Year Development Programme: A Preliminary Assessment*, Addis Ababa, Ethiopia.
- Taye Berhanu (1995) 'Entrepreneurship and the Development of the Private Sector in Ethiopia' in Ayalew Zegeye and Habteselassie Hagos (eds), *Entrepreneurship: Proceedings of the First Annual Conference on Management in Ethiopia*, Addis Ababa.
- Taye Berhanu (1997) 'The Reform Process and the Role of Associations in the Development of Small-Scale Enterprises' in Wolday Amha, G. H. R Chipande and A. Tegegne (eds) *Small-Scale Enterprise Development in Ethiopia*, Ethiopia Economic Association, Addis Ababa.
- Teferra Deguefe (1959) *Capital Formation in Ethiopia*, University College Press, Addis Ababa.
- Tegegnwork Getu (1995) 'Toward a Strategy of Economic Development in Ethiopia' in *The Proceedings of the National Workshop On Regional Development Planning and Policy Issues*, Nazareth, Ethiopia.
- Teklehaimanot Haileselassie (2000) *The Cultural Foundations of Education in Ethiopia*, Walta Information Centre, January 2000, Addis Ababa.
- Tendler, J. and Amorim, M. A. (1996) 'Small Firms and Their Helpers: Lessons on Demand', in *World Development*, Vol. 24, No. 3, pp. 407-426.
- Terefe Amberber (1996) 'Constraints and Prospects of Small Business' Addis Ababa Commercial College Small Business in Ethiopia, *Proceedings of the 4th Symposium on Human Resources Development in Business and Commerce*, Addis Ababa.
- TGE, IMF and WB (1993) *Policy Framework Paper 1993/94-1995/96*, Addis Ababa.
- Thomas, A (1998) 'Challenging Cases' in Thomas, A., Chataway, J and Wuyts, M (eds) *Finding out Fast: Investigative Skills for Policy and Development*, Sage Publications, London.



- Tsegaye Teklu (1992) 'Investment Promotion and Incentives in Ethiopia' in Mekonen Taddesse (ed) *The Ethiopian Economy: Structure, Problems and Policy Issues*, EEA, Addis Ababa.
- Udehn, Lars (1996) *The Limits of Public Choice: A sociological critique of the economic theory of politics*, Routledge, London and New York.
- UNCTAD (1996) *Incentives and Foreign Direct Investment, Current Studies, Series A*, No. 30, UN, New York and Geneva.
- UNDP (1998) *Proposal for the Implementation of the Enterprise Ethiopia Programme*, Draft, Addis Ababa.
- UNIDO (1991) *Ethiopia: New directions of industrial policy*, Industrial Development Review Series, V. 91 - 21809.
- United Nations Food and Agriculture Organisation (2000) (*Map of Ethiopia*, <http://www.fao.org/giews/english/basedocs/eth/ethadm1e.stm>)
- United Nations/WIR (1992) *World Investment Report 1992: Transnational Corporations and Engines of Growth*, UN, New York and Geneva.
- United Nations/WIR (1994) *World Investment Report 1994: Transnational Corporations, Employment and the Workplace*, UN, New York and Geneva.
- Wade, R. (1990) *Governing the Market: Economic Theory and the Role of Government in East Asian Industrialization*, Princeton University Press, Princeton, New Jersey.
- Willett, John B and Singer, Judith D (1991) 'How Long Did It Take: Using Survival Analysis in Educational and Psychological Research' in Collins, L and Horn, J. L (eds) *Best Methods for the Analysis of Change: Recent Advances, Unanswered Questions, Future Directions*, American Psychological Association, Washington D.C.
- Wolde-Emmanuel Walombo (1996) 'Small Business and Its Role in Employment in Ethiopia: Case Study' in Addis Ababa Commercial College, *Small Business in Ethiopia, Proceedings of the 4th Symposium on Human Resources Development in Business and Commerce*, Addis Ababa.
- Workie Mitiku (1997) *Determinants of Private Investment in Ethiopia*, MSc Thesis, School of Graduate Studies, Addis Ababa University.
- World Bank (1991) *World Development Report 1991*, Oxford University Press, N.Y.
- World Bank (1994) *Uruguay: The private sector, World Bank Country Study*, The World Bank: Washington, D.C.

World Bank (1997) *World Development Report 1997*, Oxford University Press, New York.

World Bank (1999) *Ethiopia at a Glance*.

World Bank (2000) *World Development Report 1999/2000: Entering the 21st Century*, The World Bank: Washington, D.C.

Yin, Robert, K (1994) *Case Study Research: Design and Methods*, Second Edition, Sedge, US.

Yohannes Kinfu (1995) 'Education and Entrepreneurship: Development, Role and Effects of Education in Entrepreneurship Development in Ethiopia' in Ayalew Zegeye and Habteselassie Hagos (eds), *Entrepreneurship: Proceedings of the First Annual Conference on Management in Ethiopia*, Addis Ababa.

Yonas Getaneh (1999) 'Critical Success Indicators in the Strategic Management of Banks: A Lesson from Bank CEOs' in *Economic Focus*, Vol. 2, No. 2, pp. 30-33.

You, Jong-Il (1995) 'Small Firms in Economic Theory' in *Cambridge Journal of Economics*, Vol. 19, pp 441-462

## 9.2 Legal Documents

AIO (1995) *A Regulation to Determine Lease Value of Land to be Employed for Agricultural Activities*, (Amharic).

AIO (1997) *The Amhara National State Investment Alternatives*, Bahir Dar. (Amharic).

COM (1993) *Investment Board Regulation*, No. 1/1993 (Amharic/1985 E.C.)

COM, FDRE (1996) *Investment Incentives Council of Ministers Regulations* No. 7/1996.

COM, FDRE (1997a) *Federal Government Commercial Registration and Licensing Council of ministers Regulations* No.13/1997, Addis Ababa.

COM, FDRE (1997b) *Addis Ababa/Dire Dawa Administration Commercial Registration and Licensing Council of Ministers Regulations* No.14/1997, Addis Ababa.

COM, FDRE (1998a) *Micro and Small Enterprise Development Agency Establishment Council of Ministers Regulations* No 33/1998, Addis Ababa.

COM, FDRE (1998b) *Investment Areas Reserved for Domestic Investors Council of Ministers Regulations* No. 35/1998, Addis Ababa.

COM, FDRE (1998c) *Investment Incentives Council of Ministers (Amendment) Regulations* No. 35/1998, Addis Ababa.



- COM, FDRE (1998d) *Investment Incentives Council of Ministers (Amendment) Regulations No. 36/1998*, Addis Ababa.
- Customs Authority/MoF (1993) *Customs Tariff*, Vol. 1 and 2, Addis Ababa.
- Customs Authority/MoF (1996) *Customs Tariff Amendment No. 1 ad 2*, Addis Ababa.
- Customs Authority/MoF (1997) *Customs Tariff Amendment No. 3*, Addis Ababa.
- FDRE (1995a) *The Constitution of the Federal Democratic Republic of Ethiopia, Proclamation No 1/1995*, Addis Ababa.
- FDRE (1995b) *Definition of the Powers and Duties of the Executive Organs of the Federal Democratic Republic of Ethiopia Proclamation No 4/1995*, Addis Ababa.
- FDRE (1996a) *Investment Proclamation No.37/1996*.
- FDRE (1996b) *Licensing and Supervision of Micro Financing Institutions Proclamation No. 40/1996*, Addis Ababa
- FDRE (1996c) *Income Tax (Amendment) Proclamation No. 36/1996*, Addis Ababa.
- FDRE (1997) *Commercial Registration and Business Licensing Proclamation, 67/1997*, Addis Ababa.
- FDRE (1998a) *Capital Goods Leasing Business Proclamation No. 103/1998*, Addis Ababa.
- FDRE (1998b) *Investment (Amendment) Proclamation No. 116/1998*, Addis Ababa.
- IGE (1950) *Statement of Policy for the Encouragement of Foreign Capital Investment in Ethiopia* (Negarit Gazeta No. 6, 1950)
- IGE (1956) *The Income Tax Decree of 1956* (Decree No. 19, 1956).
- IGE (1960) *Commercial Code of the Empire of Ethiopia of 11960*, Proclamation No 166 of 1960, Gazzet Extraordinary, Addis Ababa, Ethiopia.
- IGE (1963) *Investment Decree 1963*, Decree No. 51 of 1963.
- IGE (1966) *Investment Proclamation*, Proclamation No. 242 of 1966.
- IGE (1968) *3rd Five Year Development Plan, 1968-73*, Addis Ababa.
- PDRE (1990) *Council of State Special Decree on Investment No 17/1990*, Addis Ababa.
- PMGE (1975a) *Government Ownership and Control of the Means of Production, Proclamation No 26/1975*, Addis Ababa.



PMGE (1975b) *Public Ownership of Rural Lands, Proclamation No 31/1975*, Addis Ababa.

PMGE (1975c) *Proclamation Relating to Commercial Activities Undertaken by the Private Sector, Proclamation No 76/1975*.

TGE (1992) *Encouragement, Expansion and Coordination of Investment Proclamation No. 15/1992*.

TGE (1993) *Urban Lands Lease Holding Proclamation No 80/1993, AA*.

### 9.3 Statistical Documents

Addis Ababa Chamber of Commerce (1998) *Addis Ababa Business Directory, 1998 - 99*, Addis Ababa, Ethiopia.

CSA (1996) *Statistical Abstract, 1995*, Addis Ababa.

CSA (1997a), *Report on Urban Informal Sector Sample Survey, December 1996*, Addis Ababa.

CSA (1997b) *Report on Large and Medium Scale Manufacturing and Electricity Industries Survey, June 1997*, Addis Ababa.

CSA (1997c) *Report on Distributive and Service Trade Survey, February 1997*, Addis Ababa.

CSA (1997d) *Report on Cottage/Handicraft Manufacturing Industries Survey, March 1997*, Addis Ababa.

CSA (1997e) *Report on Small Scale Manufacturing Industries Survey, January 1997*, Addis Ababa.

Ministry of Industry (1993) *Directory of Private Industries in Addis Ababa*

ONCCP (1989) *A Socio-economic Profile of Autonomous and Administrative Regions*, Addis Ababa.

Oromia Investment Office (1997) *Investment, No. 3*, Addis Ababa (August 1989 E.C).

#### 9.4 Interviewees

People and organisations that took part in the research project<sup>81</sup>

Alemu Egiso, Operation Manager, Ethiopian Electric Power Corporation/EEPCO.  
*Interview conducted, 25 September, 1998.*

Amare Mamo, General Manager/AE3 Agro-industrial Company.  
*Interviews conducted in August, 1998.*

Amare Wodajo, Chairman/Addis Ababa Private Industries Association.  
*Interview conducted, 8 September, 1998.*

Asegid Mamo, Acting General Manager/AE2 Engineering Enterprise.  
*Interviews conducted, August 1998.*

Begashaw Shawel, Owner-manager/AE1 Shoe Factory.  
*Interviews conducted, August 1998.*

Fikre Buta, Senior expert, Addis Ababa Administration Lease Office.  
*Interview conducted, 14 September 1998.*

- 
- 81 Among the people whose names were not directly referred to in the thesis but who gave interviews and quantitative data and/or facilitated data collection include:
- (i) from Ethiopian Investment Authority: Benti Tolesa, Yosuf and Hilawi (Statistics Division), Tadesse Haile (EIA general manager), Sileshi Gebrishet (Team Leader) and W/ro Tiegist (head librarian).
  - (ii) from Ministry of Planning and Economic Cooperation (MEDAC): Admit Zerihun and Girma Wube (Department of Trade and Industry), Getachew Abebe (Foreign Economic Cooperation Division) and Admasu Shiferaw (Policy Analysis Unit).
  - (iii) from Ministry of Trade and Industry and Addis Ababa Trade and Industry Bureau: Engda Belete and Ato Kebede (Commercial Licensing and Registration Officers), Tamiru Tessema (Head of Planning Division, DAHSI) and Ato Belete (Statistics Division, Addis Ababa Trade Industry Bureau).
  - (iv) from Addis Ababa Administration Lease Office: Ato Taffes, A/head of the Auction Division, Ato Tsegaye and W/t Abeba.
  - (v) from Addis Ababa Chamber of Commerce: Ato Hussein Shibeshi and Ato Ketema.
  - (vi) from Ethiopian Electric Power Corporation: Ato Mulat, Member of the PR Office.
  - (vii) from the six case studies: W/t Yeshiwork W. Hare, Division Manager (AE3), Daniel and Samuel Begashaw (AE1), Desalegn and Mahadi (UE1).

Getachew Kebede, Head of Small Industries and Handicrafts Division,  
Development Bank of Ethiopia.

*Interview conducted, 28 August 1998.*

Kadir Kemil, Owner-manager/UE1 Shoe Factory.

*Interviews conducted, August 1998.*

Markos W/Medhin, Owner-manager/UE3 Industrial Chemicals Company.

*Interview conducted, 28 September 1998.*

Semu Nigus Shewatsega, Owner-manager/UE2 Wood and Metalworks  
Enterprise.

*Interviews conducted, August 1998.*

Semunesh Demetros, Head of Licensing, Registration and Coordination  
Department, Ethiopian Investment Authority/EIA.

*Interview conducted, 2 September 1998.*

Sendeku Araya, PR Officer, EEPCO.

*Interview given to Radio Ethiopia, broadcast on 24-25 September, 1998.*

Tahir Aman, Head of Oromia Investment Office.

*Interview conducted, 4 September, 1998.*

Tesfaye Belay, Head of Investment Policy Research and Information Department,  
Ethiopian Investment Authority/EIA.

*Interview conducted, 7 September 1998.*

Tilahun, Head of Project Follow-up and Monitoring Department, Ethiopian  
Investment Authority/EIA.

*Interview conducted, 2 September 1998.*



Appendix One: Interview Questions

Date:

Time:

Place:

PART ONE: GENERAL INFORMATION

1. Name of the enterprise: .....
2. Address of the enterprise: Woreda and Kebele .....

House No.....

Tel.....

Fax:.....

P. O. Box.....
3. Name(s) of owner(s).....
4. Name(s) of manager(s) .....

.....
5. Date of establishment.....
6. Sector and sub-sector of the enterprise .....
7. Major product/service of the enterprise:

Product/service 1 .....

Product/service 2 .....

Product/service 3 .....

9. Numbers of activity lines:

Branches of production/service units .....

Branches of dist./sales units .....

PART TWO: THE ROAD TO ENTERPRISE START-UP

Section I: Why and how to start up an enterprise?

1. What motivated you to set up this enterprise?
2. Explain and rank the importance of the following motives in setting up this enterprise:

(a) the desire to be independent

(b) threat of unemployment

(c) financial motives

(d) providing jobs to relatives and others

(e) satisfaction in enterprise building

(f) changes in public policy: o/w

- the general drive to creating a capitalist society

- provision of investment incentives

[Use a scale for ranking, where 1=not important, 2=not very important, 3=important, 4=very important]

3. Please provide the following information about the owners' characteristics [Note that S=success, and F=failure, and list as many major owners as possible]

Owner	sex	age	education	business experience (No of S/F)	family occupation	other
1						
2						
3						

4. Amount of financial capital raised for the set-up of the enterprise (by major sources and contributors if possible)

Owner	past savings	ikoub	asset sale	friends	family	bank loan	other
1							
2							
3							
Total							

5. Please state if you have owned (and thus deployed) the following resources for the set-up of this enterprise:

Owner	land (m <sup>2</sup> )	premises (m <sup>2</sup> )	vehicle (N/V)	furniture (No/Value)	others
1					
2					
3					
Total					

6. Which of the following resources did you have to acquire for the start-up of the enterprise? [m=month, and y=year, and give as many items as possible for each category of resource]

Resource		Supporting (consulted) institution	Appl. made (m/y)	Permit granted (m/y)	no. of visits made	fees paid	Was invt. licence req- uired?
(a) land							
(b) premises							
(c) vehicles							
(d) equipment and machinery	(i) (ii) (iii)						
(e) raw materials							
(f) utilities	(i) (ii) (iii)						
(g) bank credit							
(h) foreign exchange							
(i) export or import licence							
(j) other							

7. If you had to had to acquire land, please describe the procedures and challenges (from start to finish) you went through.



8. Please give estimates of time taken for the following:
  - (a) thinking about and deciding on setting up the enterprise
  - (b) implementing the project (site development - housing the enterprise, etc.)
9. What were the problems you faced:
  - (a) to get ahead with setting-up the enterprise?
  - (b) during project implementation?
10. Becoming a legal entity:
  - (a) What is the legal form of the enterprise? And why did you choose this particular legal form?
  - (b) Please explain the procedures and challenges (from start to finish) you went through to get registered as a legal business (including procedures of host ministries).
11. Why did you select this particular activity (sector)?
12. Why did you select this location?

## **Section II: Investment Incentives and Enterprises Start-up**

### **A: General Information**

1. While you were preparing to establish an enterprise, were you aware of government provision of the investment incentives scheme?
  - (a) government's provision of support in general? If yes, at what stage (in relation to developing your business ideas) and how did you hear about it?
  - (b) government's provision of support in your proposed activity area? If yes, at what stage (in relation to developing your business ideas) and how did you hear about it?
2. Is your enterprise supported by the investment incentives scheme? If yes, in what particular ways?
  - (a) direct exemptions (including duties, and income taxes)
  - (b) indirect supports (provide detailed accounts such as accesses to utilities if there were any)

3. Please provide information on major imports (or purchases) made for the set-up of the enterprise.

(a) purchase/imports of equipment and machinery	value (birr)	duty rate	other tax rates*	duty and tax paid or saved
(i)				
(ii)				
(iii)				
(b) purchase/imports of vehicles				
(c) raw materials				

4. Was tax relief (or any other benefit) extended to you on expenses such as land development, building construction, and machine installation?
5. (a) Did you seek or receive business advice from institutions (private or public) on any of the following areas? [level of support: 1=no support, 2=min. support, 3=lots of support]

Types of advice	consulted institution	level of support (if only received support)
machinery/technology import		
product export		
domestic demand		
project feasibility study		
site or building development		
others		

- (b) Were you supported by friends/relatives (or did you give favours) to get support at some of these levels?
6. Were there particular risks involved during the start-up process? If yes explain these risks and how you overcame them.

---

\* Other taxes = transaction, import and municipal taxes - information from inland revenue authority.

**B: Assisted Enterprises**

1. If you had not received incentives from the EIA, would you have set up this enterprise? If yes
  - (i) in this sector?
  - (ii) in this location?
  - (iii) at this scale?
  - (iv) at this time?
2. (a) Please explain the procedures and challenges (from start to finish) you went through in order to get an investment licence.  
 (b) How long did it take you to get an investment licence?

Applications made to: (institutions approached)	Appli. made (m/y)	Licence obtained (m/y)	no. of visits made	no of desks or dept. visited
(i)				
(ii)				
(iii)				

3. How much did the investment licence cost?
  - (i) licence fee
  - (ii) renewal fee (how many times)
  - (iii) other fees
4. Overall would you say that the support you received was essential for the set-up of the enterprise? Why or why not?
5. What particular other support would you have sought?

**C: Unassisted Enterprises**

1. Did you seek to receive an investment incentive? If not, why not? If yes, do you know why you were refused?



2.    Given that incentives are available for other activities why did you not invest in a particularly supported activity?
3.    If you had received incentives from the investment authorities, would you have set up this enterprise?

(i)     in different location?

(ii)    at a different scale?

(iii)   at different time?
4.    What particular public supports would have helped you most in setting up this enterprise?

PART THREE: ENTERPRISE GROWTH

Section I: Enterprise Dynamics

Please provide the following details about your enterprise:

1.    Type and size of capital investment (provide as many as possible):

Investment type	initial value	present value
(i)		
(ii)		
(iii)		

2.    Workforce composition by gender (full-time equivalent)

	When started	Now
male		
female		
Total		

3. Categories of Staff (full time equivalent)

	when started	now
production workers		
admin staff		
family labour		
apprentices		
others		

4. Skill Composition of workforce (the working definition of skills is in the making).

	when started	now
(a) unskilled:		
male		
female		
total		
(b) semi-skilled:		
male		
female		
total		
(c) skilled:		
male		
female		
total		

5.    Average wages and salaries: full-time rates per month

	when started	now
(a) unskilled:		
male		
female		
total		
(b) semi-skilled:		
male		
female		
total		
(c) skilled:		
male		
female		
total		

6.    Other major costs:

	annual cost when enterprise started	annual cost now
Raw materials:		
Overheads:		
(i) interest		
(ii) rent: land		
(iii) rent: utilities		
(iv) other overheads		
Total		



7. Please supply the following information:

indicator	end of the year enterprise started	end of last year
(i) gross value (sale or output)		
(ii) total operating costs		
(iii) gross profit or value added		
(iv) capital output ratio		
(v) uses of profit:		
dividends		
reinvestment		
taxes (saved or paid)		
(vi) foreign exchange earned		

8. Sources of raw materials (give as many as possible)

Types of raw materials	imported	domestic
(i)		
(ii)		
(iii)		

9. Output destination:

(a) export      (b) domestic (by regions)

10. Do you have excess capacity in production? [If yes, in what areas and why?]
11. Explain your strategies (if any) in staff/management training, planning, marketing, export development. Also explain other strategies if there are any.
12. Specifically do you have an investment plan in the coming (a) 1-2 years, and (b) 3-5 years? If yes would it be in:

- new product or service development, and or
- new branch/site development
- any other future plans?

## **Section II: Specific Constraints and Issues**

1. (a) Do you have internal problems? (Internal problems are meant to include: low morale, owners or family related problems; problems of cross-functional skills like manpower, accounts, and technology management.)  
  
(b) If yes to 'a' above how do you intend to overcome these problems?
2. (a) Do you have supply related problems (these may include infrastructure such as utilities, raw material, foreign exchange, premises, technically skilled staff, etc.)?  
  
(b) If yes to 'a' above how do you intend to overcome these problems?
3. (a) Do you have demand related problems such as domestic market, competitors, general income levels, and others?  
  
(b) If yes to 'a' above how do you intend to overcome these problems?
4. (a) Do you have policy related problems?  
  
(b) If yes to 'a' above state the particular guidelines or regulations, and aspects of the problems?
5. (a) Do you belong to professional associations?  
  
(b) If yes to 'a' above then state the organisation, and the benefits and costs of being a member?
6. Is the enterprise's management influenced by family involvement? If 'yes' please state the advantages and/or disadvantages of being a family dominated enterprise.
7. What factors are critical in the growth of your enterprise?
8. How do you measure your success?

## **Section III: The role of incentives in enterprise growth**

1. (a) In what ways did exemptions from paying income tax benefit the enterprise?

(b) Does the enterprise make profits? If yes, without tax exemptions would the enterprise be profitable?

(c) Explain the importance of exemptions from paying taxes on research and development activities for your enterprise (if you do R&D)?

2. If you did not get incentives (income tax exemptions) would you set up the enterprise in the same:

sector

location

time

scale

#### **Section IV: Regional Dimension of Income Tax Relief**

1. (a) If you were given more relief from income taxes would you set up an enterprise or invest in a remote region? [Yes or No]  
  
(b) If yes to 'a' above, how many years of concession would influence you to go to other areas?
2. Are there other factors and/or incentives you consider important to invest in other locations? [If yes please state these factors and incentives]

### **PART FOUR: VIEWS OF SUPPORT INSTITUTIONS, AND EXPERTS**

#### **Section I: Policy Makers and Planners**

EIA and Regional Bureau for Investment, and professionals in the field

1. What are the most important problems of SMEs\* in Ethiopia today?  
(a) start-up problems and (b) growth problems
2. Do you think SMEs need support? Why or why not?
3. Currently what ranges of policies (programmes) support SME start-ups and growth?

---

\* *SMEs refers to small and medium size enterprises, employing 6-50 people, and that meet the IIS criteria for support.*



4. Is support to SMEs at the expense of other activities? (Which activities are the losers?)
5. Do you think investment incentives help these SMEs, and if so how?
6. (a) What are the reasons for providing more support for a 'pioneer' area as opposed to 'promoted' areas?  
  
(b) What are the bases for supporting larger enterprises as opposed to smaller enterprises?  
  
(c) The government grants more support to enterprises setting-up in poorer regions. Why and do such grants influence investors' behaviour?
7. Why do you think most entrepreneurs who have investment licenses fail to start business?
8. Are there other (perhaps better) ways of supporting SMEs?
9. Please describe the procedures you follow when potential investors approach your institution:  
  
(a) where do investors start?  
  
(b) through which subsequent units/departments do investors have to go before they are granted (or refused) investment incentives?  
  
(c) what other services (other than fiscal incentives) do you offer potential investors?
10. Do you think the process of granting investment incentives is efficient? If there are problems with the governance structure, how would you like them to be changed?
11. (a) How is the 'one stop shop' designed?  
  
(b) Is the 'one stop shop' working? [Whether your answer is 'yes' or 'no' please explain your reasons]
12. Do you follow-up the progress of AEs? If yes, how, and what are the criteria, and outcomes of your monitoring?
13. Should SMEs be involved in the policy making process? If so how?

## Section II: Financial Institutions

1. Do you serve the SME sector, and if so in what way?
2. (a) What requirements do SMEs fulfil in order to get loans?

- (b) Do enterprise size, sector, and owner traits influence your decisions? If yes, how?
- 3. What are the major problems of your bank regarding lending to SMEs?
- 4. How do you think SMEs are best served through:
  - (a) the financial system? (b) the public sector, say to get finance?

### **Section III: City Council, and others**

- 1. How strong is demand for enterprise sites (plots of land) and office premises by investors? [Please provide evidence]
- 2. How do you prioritize demand for land (say demand for industrial site and residential houses)?
- 3. What proportion of these demands are met, and is this satisfactory?
- 4. What procedures are involved to grant either a plot of land or office premises to applicants?
- 5. How long (on the average) does it take you to allocate (a) a plot of industrial site for an investor? (b) office premises for businesses?

### **Section IV: Professional Associations**

- 1. What are the most important problems of SMEs in Ethiopia today? (both start-ups and growth)
- 2. In what ways does your organisation help enterprise start-ups and existing enterprises?
- 3. Currently what important public policies support SMEs start-ups and growth?
- 4. (a) Were investment incentives what you asked for support? If not what were your priorities?
  - (b) Do you think investment incentives equally help all categories (size and sector) of SMEs, and if so how?
- 5. (a) Do you think that the current practice of granting more support for one sector or region against the other is justifiable? Why or why not?
  - (b) Do you think larger enterprises need more support as opposed to small enterprises? Why or why not?

6. Are there other (other than investment incentives) better ways of supporting SMEs? If yes - which ones?
7. Do you think the process of granting investment incentives (by institutions like EIA) is efficient? If there are problems with the governance structure, how would you like them to be changed?
8. (a) To what extent is the bureaucratic channel a constraint to SME start-ups?  
(b) Is the 'one stop shop' working? If not how would you like the 'one stop shop' designed?
9. Should SMEs be involved in the policy making process? If so how?



## Appendix Two: Letters of Cooperation



### Faculty of Technology

Development Studies

The Open University  
Walton Hall  
Milton Keynes  
United Kingdom MK7 6AA

Telephone (01908) 653462  
Private tel: (01908) 310776  
Fax (01908) 652175

e-mail:  
s.ayele@open.ac.uk

Dear

I am an Open University PhD research student, based in Milton Keynes, England. I am conducting a study on enterprise start-ups and growth in Ethiopia with the hope of generating support frameworks (and policies) for enterprises. The study focuses on the role and efficiency of existing policies such as the investment incentives, and considers other possible support measures for enterprise start-ups and growth.

In this research your enterprise (and other enterprises) has been randomly selected. I should state that this study is conducted independently - it is neither sponsored by nor conducted on behalf of any organisation. All information you give will be treated as strictly confidential.

I understand that the questions require your time and attention. But your cooperation will enable me to properly understand the Ethiopian enterprise sector. I thank you for your cooperation, and hope to visit you again.

Seife Ayele

## Faculty of Technology

Telephone (01908) 653462  
Private tel: (01908) 310776  
Fax (01908) 652175e-mail:  
s.ayele@open.ac.uk

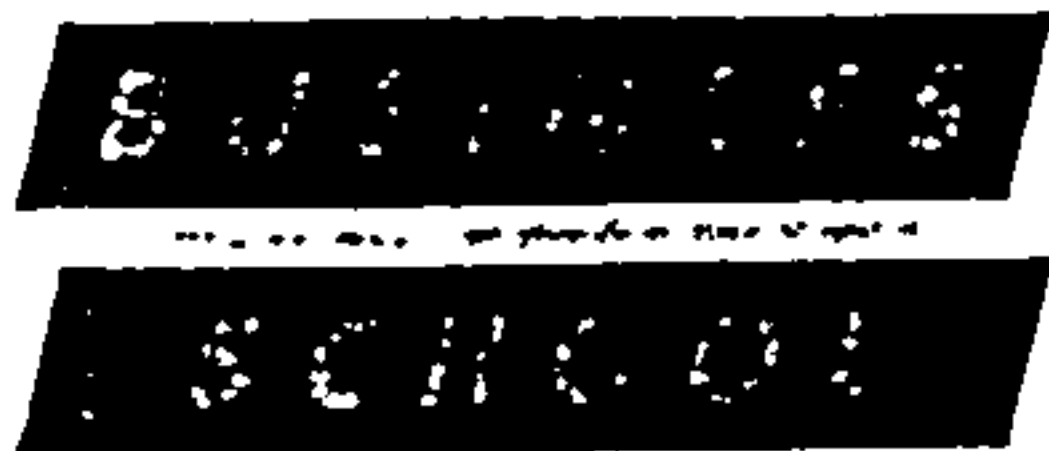
Dear

I am an Open University PhD research student, based in Milton Keynes, England. I am conducting a study on enterprise start-ups and growth in Ethiopia with the hope of generating support frameworks (and policies) for enterprises. The study focuses on the role and efficiency of existing policies such as the investment incentives, and considers other possible support measures for enterprise start-ups and growth.

Considering your responsibilities and experience in the area, I would be very grateful if you would kindly take the time to answer the enclosed questionnaire. I should state that this study is conducted independently - it is neither sponsored by nor conducted on behalf of any organisation. All information you give will be treated as strictly confidential.

I understand that the questions require your time and attention. But your cooperation will enable me to properly understand the Ethiopian enterprise sector. I thank you for your cooperation.

Seife Ayele



CG/SP/C:users:L2070798.doc



The Open University  
Business School  
Walton Hall  
Milton Keynes  
MK7 6AA

Telephone (01908) 655888  
Fax (01908) 655898  
International No. + 44 1908 655888  
<http://oubs.open.ac.uk>

Direct Line: +44 1908 653889  
e-mail: [c.w.j.a.gray@open.ac.uk](mailto:c.w.j.a.gray@open.ac.uk)

July 1998

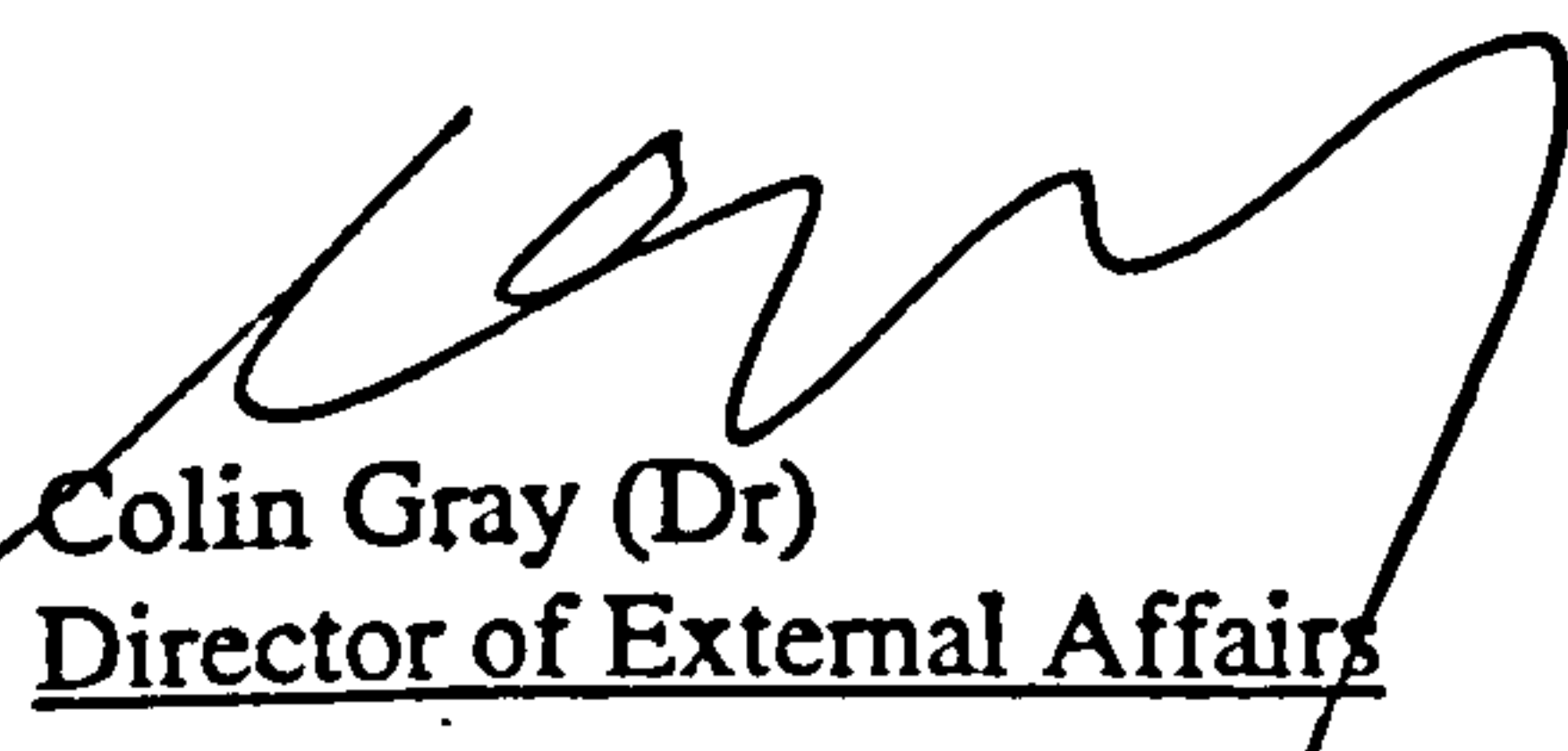
M7284877

To Whom It May Concern:

This is to confirm that Seife Ayele is registered as a part-time external postgraduate research student at the Open University, UK. He is researching small and medium-sized enterprise development, with a particular focus on Ethiopia.

I should be grateful for any assistance you can provide to Mr Ayele to further his research work.

Yours faithfully

  
Colin Gray (Dr)  
Director of External Affairs

